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Regulation

March/Apr 1978 AEI Journal on Government and Society

WILL LAWYERING STRANGLE DEMOCRATIC CAPITALISM?

LAURENCE H. SILBERMAN

The Welfare State and Electoral Politics

RALPH K. WINTER, JR.

Guadalajara! Regulation by Munificence

ANTONIN SCALIA

TRENDS IN DEREGULATION

Telecommunications–Stanley M. Besen
Transportation–Thomas G. Moore

READINGS OF PARTICULAR INTEREST

Hair Dyes and the FDA
More Regulators · Drinking Water
Glut of CB Radios
Paying for Public Participation
CPSC Revises Its Data System

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Regulation

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Competition of ideas is fundamental to a free society

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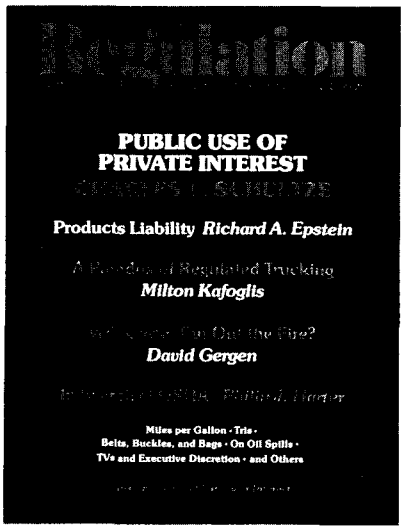
Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.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Miles per Gallon · Trio ·
Belts, Buckles, and Bags · On Oil Spills ·
TVs and Executive Discretion · and Others

The Trucking Paradox

TO THE EDITOR:

Milton Kafoglis's excellent article on the value of motor carrier operating rights (September/October issue) presents key evidence on the adverse effects of some central features of ICC regulation. As Kafoglis notes, some groups within the ICC have come to see the escalating value of operating rights as a problem—even (perhaps) an embarrassment. But thus far the commission has balked at the most obvious solution—easing entry restraints so as to remove certificates' scarcity value; instead, as Kafoglis observes, it looks toward controlling certificate transfers—which would further decrease efficiency in trucking.

For the ICC to renounce detailed entry controls and compel competitive pricing would amount to a revolution—one for which the commissioners would have to be given public acclaim for exceptional courage and altruism. But such a revolution is extremely unlikely as long as most of the ICC's support comes from the transportation providers. What is needed is a great leap forward in the commissioners' thinking—so that they reach to the general public and the commercial transport users for support, offering in exchange an economically rational set of policies designed to improve the efficiency of all transport services (even if this means less for the ICC to do). To make this feasible, education is of paramount importance, and the enlightenment afforded by Kafoglis's article is a significant contribution.

Jack Pearce,
Committee Urging Regulatory Reform for Efficient National Trucking

TO THE EDITOR:

I must take exception to the conclusion by Milton Kafoglis that "the evidence we have examined suggests that the cost of shipping goods by regulated motor carriers is excessive."

He presents one substantial piece of new information—that forty-three trades of ICC motor carrier operating rights in the period 1967–1971 represented an average compounded annual rate of increase in value of 17 percent. However, his jump from this information to the conclusion that trucking prices are excessive is based upon a series of unsupported hypotheses and opinions and a peculiar application of economic analysis.

The basic theme of Professor Kafoglis's paper is that values of operating rights represent capitalized expectations of future profits and that the cost of those rights is reflected in the prices consumers pay for trucking services. I do not argue with the basic premise that operating certificates have value only because the government controls entry to the industry. It seems perfectly reasonable that a scarce "product" (one for which demand exceeds supply) will carry a relatively high price. And it is true that the ICC blocks aspiring entrants from many trucking markets. Thus the "demand" for operating certificates in such markets exceeds the "supply" and said certificates therefore carry a relatively high price. As an employee of a firm which would like to expand into more trucking markets, I selfishly wish the prices of purchased operating certificates in certain markets were not so high.

However, as a student of transportation, I note that Professor Kafoglis has simply found an obtuse way of asking the same old question: Is there economic justification for regulating the trucking industry? The question has been asked thousands of times since 1935, and the arguments have been consistently the same. As John C. Spychalski points out ("Do Economists' Perceptions of Trucking Deregulation Conform with Reality?" 1975), short-run marginal costs are substantially below long-run average costs in many sectors of the trucking business. Therefore, open competition tends to result in extremely unstable conditions relative to price and availability of service, at least in the short run while excess capacity exists in the industry. Modern experience with independent truckers in the unregulated agricultural trucking markets is a classic example of the unstable price and capacity availability problems which plague trucking markets with unrestricted entry. Modern experience with independent truckers is also a classic example of a chronic tendency to excess capacity in many segments of the trucking industry. The Supreme Court has repeatedly ruled that such "excessive" competition can be just as compelling a reason for regulation in the public interest as natural monopoly.

The argument can be made that lower average prices to transport users in an unregulated environment more than justify the associated unstable conditions described above. Indeed, surveys of shipper attitudes on deregulation show a significant minority of shippers favoring deregulation of trucking. However, there is substantial disagreement concerning whether prices would in fact be lower, on average, in an unregulated environment. A strong case can be made that although prices might be lower for large shippers making truckload-sized shipments, prices would in the long run be substantially higher for those shippers (predominantly small) forced to rely on the small-shipment-oriented general freight motor common carrier sys-

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tem. (See my testimony, ICC Hearings on Motor Carrier Regulatory Reform, September 29, 1977.) However, for the sake of this discussion, I will accept Professor Kafoglis's contention that trucking freight rates would drop under deregulation to the extent that current prices reflect a cost of ICC operating certificates.

The question, then, is whether stability lent to the transport markets through ICC control of entry into the motor carrier industry is worth the cost.

It has been shown repeatedly that shippers, on balance, value consistency of service as highly as speed of service, and that they generally are willing to pay a substantial premium for quality of service and reduced uncertainty. For example, Alexander Morton's study ("Truck-Rail Competition for Traffic in Manufactures," 1971) estimated that shippers, on average, will pay 15 to 20 percent more for truck service than they will pay for rail service on the same shipment.

When Professor Kafoglis says that trucking prices are "excessive," one would presume he means "relative to the premium shippers are willing to pay for quality and stability." Unfortunately, he does not offer an estimate of the percentage of trucking prices that represents the excess profits which purportedly are reflected in market values of operating rights.

I have used two different methods to provide such an estimate. The first is based on the economic theory that any future "excess" profits that investors in general expect a firm to earn will be reflected in the excess of market value of the firm over tangible book value. This method generates an estimate, based on 1977 median average market value/tangible book value ratios, of before-tax excess profits equal to .6 of 1 percent of 1977 estimated trucking revenues. Some theorists would argue that the current prices of trucking stocks have been discounted to reflect the risk of deregulation and that historical market value/tangible book value ratios would thus be more appropriate. I disagree. In any event, use of a five-year average for 1973–77, a period which includes the glamour years for trucking stocks, puts "excess" profits at 2 percent of trucking revenues.

A second method of estimating "excess" profits was suggested by Professor Kafoglis in the original version of his paper released by the Council on Wage and Price Stability. His method was based on a misinterpretation of data released by the American Trucking Associations (ATA) and produces estimates which the ATA says are outlandishly high. This method puts "excess" profits at 4 percent of trucking revenues. (The math of the two methods is available on request.)

My estimates are not intended to imply a high degree of scientific precision, but rather to put Professor Kafoglis's charge—that trucking rates are excessive—in perspective. Even if trucking rates would be reduced through elimination of entry controls in an amount equal to the implied cost of operating certificates (which is disputed by trucking experts), the reduction would lie in a range from .6 of 1 percent on the low side to 4 percent on the high side. Considering that shippers have been shown to be generally willing to pay premiums of 15 to 20 percent for high-quality service and reduced uncertainty, the Kafoglis conclusion seems very much not supported by the evidence.

Professor Kafoglis would have made a more useful contribution to resolving the regulatory reform controversy if he had developed a method for eliminating entry controls without destroying the stability inherent in the existing system.

Michael L. Lawrence,
Philadelphia, Pennsylvania

MILTON KAFOGLIS responds:

I share Jack Pearce's concern about the need for changed incentives so that regulators are encouraged to behave in the public interest. Though the outlook for such change seems bleak, we can take some comfort in the knowledge that there have been (and are) regulators who single-mindedly pursue the public interest, irrespective of the consequences to the bureaucracy, the industry, or their personal fortunes.

Notwithstanding the availability of such persons, comprehensive reform of trucking regulation is urgently needed. The reason is that, as things stand, the motivation to regulate in the public interest is severely blunted by statutory law and court precedents. Some members of Congress recognize the need for legislation, and we can hope that this number will grow as the facts become known and the public becomes more deeply involved. I appreciate Mr. Pearce's judgment that my analysis has contributed to this effort.

Michael Lawrence, on the other hand, finds my effort a peculiar and obtuse application of economic analysis. He does not question "the basic premise that operating certificates have value only because the government controls entry" and he affirms the empirical consequence of my analysis by asserting that "there are more truckers wanting to get into many trucking markets than the law . . . will allow." He also agrees, albeit grudgingly, that truck rates are higher with entry restrictions than they would be without them. We are agreed, then, that there is a waiting line of truckers ready to provide service at lower rates than now exist, if only the law would permit.

Though this state of affairs displeases me, it is a source of comfort to Mr. Lawrence. He claims that control of entry prevents "instability" and encourages "improved service," benefits which he alleges are well worth the higher price. The basis for his argument is that, in trucking, "short-run marginal costs are substantially below long-run average costs." Under such conditions, competing firms could reduce price in the short run to a point where none could survive in the long run. Thus, relaxed regulation would lead to "instability" and "chaos."

Economists would agree that, in certain unusual circumstances, the cost conditions described by Mr. Lawrence could lead to the results he fears. However, it is unnecessary to detail these circumstances because the requisite cost conditions do not in fact exist in the trucking industry where 80 to 90 percent of the costs are variable over a very short period of time. The high ratio of variable to total costs in trucking means that price cannot fall far enough below total cost for long enough to create persistent excess capacity and so-called "destructive competition."

I do not question that relaxed entry might "be destructive" to *firms* unable to withstand the competition of more efficient or innovative firms. But I do argue that *service to consumers* would not be destroyed or seriously threatened since such firms would be quickly replaced from the waiting line of truckers eager to serve. (The existence of the waiting line is not in dispute.) Truckers, like restaurants, can come and go, but consumers will continue to be serviced. Whatever instability open competition would create would be of the sort we see every day: the inefficient are driven out of business while the

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customer finds a superior supplier, possibly at a lower price.

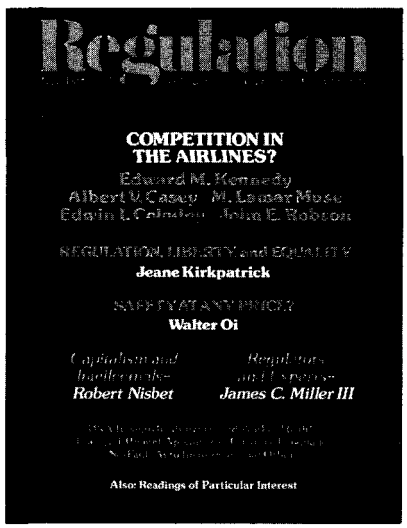
Mr. Lawrence seems to believe that competition will deny shippers the "premium" services which he alleges are provided by the regulated carriers. However, current ICC regulation (along with the motor-carrier rate bureaus) effectively prevents carriers from offering a less (or even more) deluxe service at a lower (or higher) price. In a competitive trucking market, shippers who want premium service at a higher price or less deluxe service at a lower price would find suppliers ready to meet their specific needs. ICC regulation prevents the rich variety of price-service options that the competitive market can provide. So much for theory; what are the facts?

Mr. Lawrence calculates that the premium now paid to truckers, *to the extent it contributes to excess profits*, is between .6 and 4 percent of total trucking revenues. He further guesses that shippers are "willing to pay premiums of 15 to 20 percent for high quality service and reduced uncertainty." These calculations and guesses leave the inference that regulation is a bargain for the shipper. However, they do not consider the actual cost of the alleged premium service that is also reflected in trucking rates. The trucker's excess profits (which Mr. Lawrence believes are the only matter in question) are simply payments over and above what is necessary to pay for the actual services received by shippers. Beyond the excess profits and payment for so-called premium services (which they may not want), shippers must also pay the costs of route inflexibility, route circuity, and other inefficiencies generated by regulation, while taxpayers must support a regulatory bureaucracy at all levels of government. The "bargain" inferred by Mr. Lawrence's calculations is a fiction.

Mr. Lawrence cites (but does not describe) the "conditions which plague" the unregulated agricultural trucking markets. To my knowledge, the shippers of agricultural commodities do not have greater complaints than other shippers, and they pay much lower rates. When the list of exempt agricultural commodities was expanded in the 1950s, competitive pressures led to rate reductions of about 20 percent, and most shippers perceived an improvement in service.

This historical experience is now being repeated in the recently expanded commercial zones (areas around cities that are exempt from regulation). According to the *Journal of Commerce* (January 6), preliminary studies reveal that this limited deregulation has led to rate reductions ranging from 2 to 50 percent, with the average being about 20 percent. It is also reported that some truckers are in "distress." This gives credence to some of Mr. Lawrence's fears, as well as to my own view, that inefficiences on the part of the regulated will be exposed and eliminated by open competition. The same newspaper account states that a survey of 2,000 shippers revealed that "half felt the recent commercial zone expansion improved their LTL service, while a third said it lowered shipping costs." Though regulated truckers (like all those who compete) are having a hard time, service to the public has not been disrupted and prices are lower.

Indeed, what factual information we have tends to suggest that the predictions of those who favor relaxed entry and price competition may have been too modest. It is beginning to look as if rates will fall and service will improve with regulatory reform. Put another way, regulation may have encouraged shoddy service at a premium price, a result the opposite of that claimed by Mr. Lawrence.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Also: Readings of Particular Interest

Kirkpatrick and Critics

TO THE EDITOR:

In her recent essay ("Regulation, Liberty, and Equality," November/December issue), Jeane Kirkpatrick attacks the belief that equality is the enemy of liberty in a democratic welfare state. In fact, she goes even further than that by arguing that actions taken by government to make people more equal often create more liberty as well. Whether that proposition is valid depends on the meaning to be given to liberty and equality.

Professor Kirkpatrick starts off on the right foot when she speaks of liberty in the classical sense as absence of coercion or, more specifically, as freedom from government. But she quickly slides into a "positive" concept of liberty that also encompasses the capacity to realize desired goals. In effect, she takes liberty to mean freedom from want, and freedom from coercion to be merely one aspect of freedom from want.

In doing so, she creates confusion, because freedom from coercion is something quite different from freedom from want, and failure to distinguish the two is bound to beg issues that have been of fundamental concern over the ages. In brief, a slave may be well fed and otherwise free from want, but he is still a slave. In a more relevant context, when a democratic government takes property from Peter and gives it to Paul, the transfer of wealth must be justified on the ground that the resulting improvement in Paul's well-being is worth more than the combined loss of well-being and liberty suffered by Peter. There is no increase in Paul's liberty to enter in the balance. It follows immediately that governmental policies designed to bring about greater equality of circumstance necessarily diminish liberty properly defined.

Having said this, I hasten to grant that there are other categories of social equality that need not clash with liberty. Contrary to what Professor Kirkpatrick states at one point, liberty should not be construed as a boundless concept, extending even to the "freedom to kill." According to the precepts of classical liberalism, no person should be free to coerce others or to infringe on their freedom in other ways. Nor should anyone be free to sell himself into slavery or to lie, cheat, or steal. There must, then, be some political order—some legitimate coercive agency—embodied in any free society. Hence governmental policies designed to promote equality before the law or equality of opportunity or equality of treatment in other relevant respects need not be incompatible with liberty.

G. Warren Nutter,
University of Virginia

(Continues on page 52)

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Perspectives
on current developments

Hair Dyes, Cancer, and the FDA

The catalyst for the current controversy over regulating permanent hair dyes is a finding by the National Cancer Institute that a principal ingredient of these dyes causes cancer in animals. Subsequent to the release of this finding, the Food and Drug Administration announced (*Federal Register*, January 6, 1978) that it would require certain coal-tar hair dyes to bear a label warning consumers that the ingredients had caused cancer in laboratory animals. The resulting debate is a microcosm of the problems of legislation, laboratory testing, and conflicting views about appropriate government action that often complicate the regulation of substances posing chronic health hazards.

As for the legislation, the Food, Drug, and Cosmetic Act of 1938 authorizes the FDA to regulate cosmetics (including hair dyes) and, in most cases, to remove demonstrably dangerous cosmetics from the market. But in the case of coal-tar hair dyes, Congress limited the FDA's authority to requiring that package labels carry warning information. The merits of the limitation have been argued intermittently for forty years, but all attempts to modify it so far have failed.

As for the second problem, regulation of health hazards often depends on results from laboratory testing involving animals. In the case of coal-tar hair dyes, NCI researchers fed test groups of male and female rodents either high or low doses of a principal chemical (2,4-diaminoanisole sulfate) of these dyes, and post-mortem examinations of the test and control groups indicated higher incidences of some forms of cancers among all test groups. The matter at issue is the relevance of this finding for humans.

The Cosmetic, Toiletry and Fragrance Association, Inc., in recent testimony before the Congress, argued strongly that NCI's finding does not justify regulatory action since humans apply the substance to their hair; they do not eat it. The CTFA cited five industry-sponsored studies which concluded that rats whose skins were painted with hair dyes showed no increase in cancer. Stressing the significance of this result, the association said that even though the skin application method reduces drastically the amount of the chemical absorbed into the bloodstream, the test animals still absorbed far greater amounts, allowing for their size, than would humans using hair dye.

Laboratory testing on animals, of course, does not provide direct evidence that a suspect agent causes cancer in humans. But sometimes it is all the regulator has to go on. Ethical and legal restrictions prevent long-term testing on humans, and epidemiological studies on humans are extremely difficult to conduct, with years passing before very definitive findings are available. Thus, the extent, if any, to which a chemical in coal-tar hair dyes increases the incidence of cancer in humans is not really known.

As for the problem of conflicting views about the appropriate regulatory response, it is complicated in this case by the nature of the scientific data. The FDA's position is that any chemical yielding positive results in animal tests must be considered a potential hazard to humans and therefore be banned from the market. The CTFA's view is that informed consumers should weigh the risks and benefits of products they consider purchasing but that, in the case of hair dyes, the scientific evidence is so inconclusive that there is nothing about which consumers need to be informed.

Both approaches have their drawbacks. The FDA's alternative, pushed to its extreme, would deprive consumers of goods they may value highly and for which they would assume some risks. The saccharine controversy clearly demonstrated the willingness of some consumers to incur potential health risks for products they like. Yet, the association's alternative,

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pushed to its extreme, might result in some consumers' using potentially dangerous products while assuming that the FDA is protecting them from excessive risks.

Millions of CBs That Can't Be Sold

Not too long ago, citizens' band radio was unknown to most of us. During the 1950s the Federal Communications Commission established a Class D Citizens' Radio Service having twenty-three channels and a range of from five to twenty-five miles. The service was open to almost everyone—that is, no specialized technical knowledge was required to obtain a license. Citizens' band activity grew slowly during the sixties but took off in the seventies: sales almost tripled each year between 1970 and 1974. If that growth rate had been sustained, the United States would have been covered by a layer of CB radios within fifty years.

Several factors combined to produce the explosive growth in CB radio sales. Advances in electronic technology reduced the cost of CB radios while improving their quality. Increased sales made them more valuable, since each additional CB user on the road meant another pair of eyes and ears reporting road hazards. Further, CBs attracted publicity during the 1974 truckers' strike, gaining glamor and becoming something of a consumer fad.

But growth also led to congestion on CB channels and interference with home television reception. In July 1976, the FCC took a major step to resolve these two problems: it expanded the number of CB channels from twenty-three to forty and tightened the restrictions on "extraneous radiations" for CB sets so as to reduce interference with television reception. To ease the effect on the industry, it ordered that the new forty-channel sets not be put on the market before January 1, 1977, that the manufacture of sets not meeting the new, tighter radiation limits cease by August 1, 1977, and that retail sales of such equipment cease five months later (January 1, 1978).

Despite the advance notice and general industry support for the FCC's initiative, confusion overwhelmed the CB market. Whether because the market was already saturated or because consumers were confused by the change from twenty-three to forty channels, the demand for sets weakened. Consequently, late in 1977, retail inventories included millions of units that could be legally sold for only a few more months. Retailers who had inaccurately estimated demand for the old sets—or who had become aware of the ban too late—were faced with the prospect of owning merchandise they could not sell. Prices tumbled, but sales still were not sufficient to deplete the inventory.

In August 1977, manufacturers and retailers petitioned the FCC to extend the sales deadline on old sets from January 1 to August 1 (1978). Consider the FCC's dilemma when asked for this extension. If the FCC granted the petition, manufacturers, distributors, and retailers who had dumped their inventories in anticipation of the January deadline would suffer significant losses because of a seemingly capricious regulatory action. If the FCC held fast, millions of dollars of perfectly good hardware would probably be scrapped. The chief engineer of the commission supported the request for an extension, but the commission itself, seeing no easy way out, chose consistency and voted it down, four to two. Retail interests appealed in court, but the court denied a stay, and the sale of the old twenty-three channel units became illegal at midnight New Year's Eve. According to some accounts, retailers who have millions of these units are engaged in enormous haggling with manufacturers over who is going to bear the loss.

New Federal Budget Calls for More Regulators

If the 1979 budget is any guide, the increase in regulation undertaken by the federal government will continue. Of course, larger budgets for regulatory agencies do not necessarily mean more regulation, since the additional resources could be consumed by efforts to reduce regulation or by reduced agency productivity. Nonetheless, the amount of activity an agency undertakes would appear, in most cases, to be positively related to its available resources. More specifically, the number of regulators and supporting staff is one measure of an agency's capacity to increase the detail and breadth of its regulation.

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GROWTH IN EMPLOYMENT FOR THIRTY REGULATORY AGENCIES

Agency	Number of Employees [a] 1977	1978	1979	Percentage Increases (Decreases), 1977–79
GROUP I				
Equal Employment Opportunity Commission	2,298	2,312	3,114	35.5
National Labor Relations Board	2,751	2,886	2,984	8.5
Occupational Safety and Health Administration	2,591	2,655	2,650	2.3
Employment Standards Administration	3,114	3,209	3,509	12.7
Federal Trade Commission	1,648	1,650	1,716	4.1
Antitrust Division	907	920	977	7.7
Securities and Exchange Commission	1,930	2,025	2,065	7.0
Patent Office	2,673	2,640	2,597	(2.8)
Consumer Product Safety Commission	914	900	899	(1.6)
Food and Drug Administration	7,340	7,490	7,583	3.3
Environmental Protection Agency	9,779	10,216	10,840	10.8
International Trade Commission	348	386	386	10.9
TOTAL, GROUP I	*36,293*	*37,289*	*39,320*	*8.3*
Internal Revenue Service	70,609	71,467	73,607	4.2
GROUP II				
Civil Aeronautics Board	779	790	820	5.3
Interstate Commerce Commission	2,161	2,133	2,128	(1.5)
Federal Maritime Commission	304	345	351	15.5
TOTAL, GROUP II	*3,244*	*3,268*	*3,299*	*1.7*
GROUP III				
Federal Aviation Administration	55,760	56,495	56,640	1.6
Coast Guard	6,333	6,421	6,421	1.4
Customs Service	13,519	14,581	14,903	10.2
National Highway Traffic Safety Administration	818	878	878	7.3
Federal Railroad Administration	1,447	1,604	1,642	13.5
TOTAL, GROUP III	*77,877*	*79,979*	*80,484*	*3.3*
GROUP IV				
Federal Reserve Board	1,516	1,516	1,520	.3
Federal Deposit Insurance Corporation	4,162	4,362	4,500	8.1
Federal Home Loan Bank Board	1,363	1,475	1,503	10.3
Comptroller of the Currency	2,907	3,002	3,186	9.6
National Credit Union Administration	576	639	639	10.9
TOTAL, GROUP IV	*10,524*	*10,994*	*11,348*	*7.8*
GROUP V				
Energy Regulatory Administration [b] / Federal Energy Regulatory Commission [b]	2,893	1,999 / 1,403	1,999 / 1,403	17.6
Energy Information Agency [b]	631	776	776	23.0
Nuclear Regulatory Commission	2,499	2,723	2,788	11.6
TOTAL, GROUP V	*6,023*	*6,901*	*6,966*	*15.7*
TOTAL, ALL GROUPS	*204,570*	*209,898*	*215,024*	*5.1*
TOTAL, FEDERAL EMPLOYMENT	*1,908,988*	*1,930,100*	*1,931,600*	*1.2*

[a] Full-time permanent employment as of September 30. [b] Department of Energy.

Source: Based on the *Budget of the United States, 1979*, and the Department of Energy.

Turning to the President's budget to get the numbers on regulators and supporting staff, we find there no conveniently assembled list of planned appropriations for all regulatory activity. So the data in the accompanying table reflect our selection of regulatory agencies, based on normal usage of that term.

Agencies are grouped according to their jurisdiction. Group I agencies have broad jurisdiction under specific regulatory statutes; Group II agencies engage in economic regulation of transportation services; Group III agencies regulate transportation goods and services for safety and other objectives; Group IV agencies regulate financial institutions, and Group V agencies engage in economic regulation of energy. The table gives proposed end-of-year employment estimates of thirty agencies for September 30, 1978 and 1979, as well as actual employment levels on September 30, 1977. (Budget estimates for 1978 are, to a large extent, influenced by already completed congressional action on the 1978 budget.)

As shown in the table, total federal employment is projected to increase by 1.2 percent during this two-year period, compared with 5.1 percent for our thirty regulatory agencies. For the same period, employment increases are expected to average 8.4 percent for the agencies in Group I, 4.2 percent for the Internal Revenue Service, 1.7 percent for the agencies in Group II, 2.2 percent for Group III, 7.8 percent for Group IV, and 15.7 percent for Group V.

While the future level and direction of regulation cannot be derived from budgetary estimates alone, the President's 1979 budget clearly calls for continued growth in regulatory capacity.

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CPSC Redesigns Its Injury Information System

Whether explicit or implicit, all federal regulatory agencies have some basis for deciding which issues to address. The Consumer Product Safety Commission not only does this explicitly, but gives the appearance of an unusual degree of sophistication by setting its priorities on the basis of a computer printout.

The CPSC is required by law to assure consumers that products are not unnecessarily hazardous. In order to obtain information on a systematic basis about which products cause the most injuries, the commission established a National Electronic Injury Surveillance System (NEISS) in 1972. This system is based on a sample of 119 hospitals, each of which supplies emergency room data on product-related injuries. Information on the patient's age and sex, the type and severity of injury, and the product involved is coded and transmitted daily to the CPSC computer. (NEISS notes only whether the product was involved in the accident, not whether it *caused* the accident.) The data are compiled monthly to determine the frequency and average severity of injuries associated with specific products. Products ranking highest on a combined frequency-of-injury/severity-of-injury scale are given priority attention for possible regulatory action.

Injuries of particular interest to the CPSC (those resulting in death or associated with flammable fabrics) may be subjected to follow-up investigations designed to obtain, when possible, the victim's account of the accident and to determine the extent to which the product caused the injury in question. To make the most of the person's memory and to reduce the likelihood that the product involved would have been discarded, investigations are conducted within seventy-two hours of the report.

The CPSC views NEISS as the best single source of statistics on product-related injuries. This is because the data are collected at a reasonable cost and are estimated to cover some 40 percent of the country's product-related injuries. But the difficulties involved in relying on such a system are apparent. First, there is the problem of how much confidence can be placed in projections based on the sample. Since data generated from the sample must be "inflated" to estimate total injuries treated in all emergency room hospitals, and then be further inflated to represent the entire injury picture (emergency room and non-emergency room), the statistical accuracy of the sampling base is very important. But the current sample is derived from dated hospital and population figures, represents just the forty-eight contiguous states, and includes only 119 of the 4,906 hospitals that had emergency treatment units in 1968. In addition, its statistical accuracy has been diminished by the fact that some hospitals originally included on the basis of random selection have left the program and have had to be replaced.

To correct these deficiencies, the CPSC is now redesigning NEISS. The sample for the new system will be larger (130 hospitals instead of 119), will be selected on the basis of current data, and will include hospitals in all fifty states. An attempt will be made to use only the initial—randomly selected—hospitals. Hospitals from which the sample will be drawn are grouped into five categories based on facilities and numbers of emergency room visits, and each category's weight in the sample depends on how many hospitals fall in that category. Finally, since accurate and uniform information collection and coding are crucial, full-time CPSC employees will be placed in the new hospitals to perform these functions. (Most of the data are currently supplied to the CPSC by trained hospital personnel.)

The second problem relates to the utilization of NEISS data. Many have argued that the frequency/severity ratings would be more useful to the commission if the system included additional information about the products involved—such as their age and frequency of use. Information on product age might be used to analyze the effectiveness of "voluntary" safety standards self-imposed by industry and the relative safety of products of differing ages (product-age information is now collected only during follow-up investigations). Frequency-of-use information might be used to distinguish low-accident-rate products that are frequently used from high-accident-rate products that are infrequently used, thus giving the CPSC more information on the innate riskiness of different products.

One thing to bear in mind about NEISS is that it can, at best, suggest only the *benefits* of

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eliminating product risks. As the commission itself has noted, other factors, such as the cost and likely effectiveness of regulating a product, are considered before action is taken. But some have suggested—the Council on Wage and Price Stability, for instance—that since NEISS directs attention to products solely on the basis of benefits, a misallocation of commission resources might result. The alternative is a priority ranking scheme based on *net* benefits—that is, the difference between the benefits of removing (or reducing) a product risk and the cost of doing so. This would enable the CPSC to allocate its own internal resources so that, on balance, society would gain the most from the commission's actions.

Tighter Standards for Drinking Water

The Environmental Protection Agency is proposing new regulations for sharply reducing cancer-causing agents in municipal water supplies. This action, announced in the *Federal Register* on February 9, would amend EPA's 1975 interim drinking water regulations, which controlled harmful organic compounds only to a very limited extent.

EPA's proposal has two parts. (1) For trihalomethanes (THMs, that is, carcinogenic chemicals such as chloroform that are created when chlorine is added to drinking water), EPA would set a containment level of 100 parts per billion. (2) For water supplies susceptible to contamination by synthetic organic chemicals other than those resulting from chlorination, EPA would mandate a specific water-treatment technique.

Both parts of the regulation would initially apply only to communities of more than 75,000 people. One reason for the limitation is that the danger from exposure to THMs is less for small communities than for large—since the latter usually rely on surface water supplies that tend to have high bacteria counts and thus require more chlorine for purification. Another reason for limiting the standard to large communities is to minimize administrative problems and capital costs while still covering nearly 50 percent of the population.

The proposal outlines three ways of satisfying the THM requirement, their cost increasing with the seriousness of the problem. First, a community whose water slightly exceeds the allowable THM level could improve its filtration process through better coagulation and sedimentation practices (assuming it has a conventional filtration plant). Second, in more serious cases, a community could resort to disinfectants that do not produce THMs (such as chloramines, ozone, or chlorine dioxide). Third, in the most serious cases, a community could use a granular activated charcoal (GAC) filtering system. This last option appears to be the most practicable way for municipalities of over 75,000 to meet the allowable THM level since many large water supplies greatly exceed that level, and since other disinfectants are either relatively weak or potentially toxic.

As for the second part of the proposal, EPA decided to prescribe the GAC filtering system in this case because it would be difficult to monitor each synthetic organic chemical that might have an adverse health effect, and because synthetic organic chemicals other than THMs are best controlled by using the GAC filtering system. The proposal would affect water supplies that are near industrial discharges, pesticide run-offs, or other sources of possible contamination.

The cost of implementing both parts of the proposal would depend on how many municipalities have to adopt the GAC filtering system to meet the THM containment level. According to information supplied by EPA, total capital expenditures required by the combined proposal would appear to range from $291 million under low-cost assumptions to $685 million under high-cost assumptions. Operations and maintenance expenses would be between $34 million and $92 million per year under the same assumptions. The cost would also depend upon how long the water had to be purified (contact time) and how often the carbon in the GAC system had to be replaced (regeneration). Actual increases in residential water bills would depend on what portion of the costs was borne by nonresidential water users.

EPA's analysis of the proposed regulation makes no attempt to estimate benefits in terms of either dollar savings or reduced risk of cancer. Without such information, the agency has no way of determining whether, given alternative demands for public and private re-

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sources to eliminate health hazards, the proposed regulation is the most cost-effective means of achieving this goal.

Funding Public Participation in Regulatory Proceedings

In 1975, Congress authorized the Federal Trade Commission to compensate "interested persons" for their expenses in participating in agency rulemaking proceedings, if three conditions are met. The FTC must find (1) that the applicant represents an interest "which would not otherwise be adequately represented," (2) that the representation of that interest is "necessary for a fair determination of the rulemaking proceeding," and (3) that the applicant is financially unable to participate effectively without compensation.

In 1976, the General Accounting Office ruled that other regulatory agencies had general authority to pay the expenses of persons who would contribute substantially to a full and fair determination of a proceeding. Fortified by the GAO's position, additional federal agencies have proposed or adopted regulations to provide compensation funds. For instance, the National Highway Traffic Safety Administration budgeted a total of $250,000 for this purpose in 1977. But the recent case of *Greene County Planning Bd.* v. *FPC* (2d Circuit 1977, certiorari denied 1978), in which the court held that the FPC did not have authority to make public participation grants, raises doubts about the correctness of the GAO rulings.

A bill sponsored by Senator Edward Kennedy (S. 270) would create a government-wide program of compensating interested persons who participated in all types of regulatory proceedings (rulemaking, ratemaking, licensing, adjudication, and judicial review of agency decisions). Two conditions are specified. First, the applicant would have to be expected to contribute substantially to a fair determination of the proceeding. In deciding this question, the agency would have to take into account the possibility that other participants (except the agency itself) would adequately represent the interest, the number and complexity of the issues, the importance of encouraging public participation, and the need to hear from a balance of diverse interests. Second, the agency would have to consider the applicant's financial position. Compensation would be paid if the applicant could not participate without it or if the applicant's financial stake in the outcome were small compared with the costs of effective participation. A similar bill, H.R. 8798, is pending in the House.

Proponents of compensation for public participation point out that their proposals would not expand the existing legal rights of "interested persons" to participate in agency proceedings but are designed, instead, to overcome the high costs of exercising these rights. They argue that for some groups who stand to gain or lose from agency action, effective participation costs more than the members are willing to contribute.

Opponents of the idea maintain that additional participation would make agency proceedings more costly and time consuming, without demonstrably improving the quality of agency decisions. They also assert that a better way to guarantee representation of all interests would be to charge agency staffs with that responsibility. Furthermore, some critics worry that, in disbursing compensation funds, agencies would display favoritism or would reward and ultimately "capture" the representatives of interested persons or groups. They point out that the Kennedy bill would vest more discretion in the disburser than the FTC now has and that there is some controversy about how well the FTC program has worked.

Proponents respond that the problems of additional cost and delay could be offset by improved management of both the compensation program and the particular proceeding. They reject, on the basis of their experience, the argument that agency personnel can adequately represent disparate interests. And some of them contend that the risks of an agency's showing favoritism or "capturing" subsidized representatives can be reduced by having an outside agency make the compensation awards. Others, however, resist the notion of a central compensating organization.

Many other issues of organization, funding, and eligibility are also in dispute. Undoubtedly, the issue will receive much attention in view of the recent defeat of the proposed Consumer Protection Agency.

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Viewpoint

Ralph K. Winter, Jr.

The Welfare State and the Decline of Electoral Politics

CONCERN OVER burgeoning government increases even among staunch supporters of the welfare state. Calls for reducing the size of government and for deregulating many industries are heard on the Left as well as on the Right. There seems, moreover, to be a widening consensus that many social welfare expenditures cannot be justified as measures that help the less well off. Nevertheless, the growth of government proceeds unchecked.

There is also a concern that voters are increasingly indifferent to electoral politics, perceiving them to be increasingly irrelevant. In 1976, although the presidential contest became a virtual toss-up in its last weeks, the percentage of the voting-age population that actually voted was smaller than in the no-contest campaign of 1972. Congressional candidates of all persuasions also seemed unable to turn on the voters, who appeared interested in the campaign more as spectators than as participants.

These perceptions—that government continues to grow while an anti-government philosophy prevails among voters and that voters increasingly regard electoral politics as irrelevant—are related phenomena, for, as I suggest below, once the welfare state reaches a certain size, a partial paralysis of the political process is likely to occur. The result of this paralysis will be that the size of government cannot be easily controlled by normal democratic processes and confidence in electoral politics will decline.

The prevailing political rhetoric indicates that philosophically most voters want less government, less taxes, less inflation, along with the maintenance of a decent level of support for the genuinely poor. These do not appear to be impossible or inconsistent tasks. To the contrary, the increase in social welfare expenditures by federal, state, and local governments between 1960 and 1971 alone, if given directly to the poorest 25 million people, would provide a family of four with an annual income of about $19,000. Since that far surpasses the median income—not to mention the poverty line—we can in fact eliminate poverty, reduce taxes and inflation, and limit the size of government by the simple act of giving only some of the money already devoted to social welfare directly to the poor and leaving the rest with the taxpayer. Further reductions in the size of government and in the price of consumer goods would be achieved by eliminating a number of regulatory programs that economists almost universally agree are a source of economic inefficiency and harm to consumers.

Although these options may seem irresistible, few enterprising candidates would dream of running on such a program in most states or congressional districts. The vast bulk of welfare state programs do not aid just the poor but spread their benefits widely and without regard to need—because, as Irving Kristol has written, "Congressional compassion is always tempered by political realism, and the congressional impulse is always to spread its compassion over the largest possible share of the electorate."

No one seriously believes existing farm programs are designed to aid only the poorest 10 percent, or even 20 percent, of our farmers. Veterans' programs involve enormous funds but no one claims they are designed only to

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help poor veterans. Aid to education has its most direct impact on middle-class teachers, while the school lunch program is fighting poverty at the fanciest private schools. Even expenditures for the truly poor fall to a disturbing degree into the hands of middle-class professionals and administrators.

The idea of the welfare state as a means for protecting individuals or families against catastrophic illness or genuine deprivation—and, in the words of Jeane Kirkpatrick, as a means for "providing a minimum of income and security for all" (*Regulation*, November/December)—has in practice been abandoned. In its stead is the notion that no material desire is necessarily outside government's responsibility.

So too we have come to act as though no economic hardship—no matter how minor or how related to changes in consumer tastes—needs to be tolerated, even at the price of a government-supported monopoly. We have thus witnessed the steady growth of a regulatory apparatus designed to protect particular groups from market competition. Almost all interstate commercial transportation is a federally protected cartel. Other industries benefit from import quotas or analogous restrictions on foreign competition. Many businesses receive direct or indirect subsidies from government, and work on government contracts is usually done at inflated wage scales. Although none of these programs directly helps the genuinely poor, and all penalize consumers or taxpayers, they are generally accepted as a routine exercise of government's legitimate responsibility.

IT IS EASY enough to understand how spreading political compassion over as many voters as possible got us into our present regrettable posture. It is harder to understand why, with many signs indicating that voters want a change, we do not extricate ourselves.

One problem is that we are conditioned to view the welfare state as an instrument of compassion and generosity rather than as the benefactor of special interests. Even relatively conservative candidates, for example, when confronted with an opponent who declares, "America can do more in the fields of housing, education and aid to our cities," tend to react defensively and object only on grounds of cost. Rarely do they challenge the sincerity of that candidate's compassion for the poor. Yet the specific voters appealed to are for the most part not the poor—who are a relatively small fraction of the total population and a much smaller fraction of those who actually vote—but the construction industry and those who serve it (insurance brokers, for example), teachers at all levels of education, students (who are generally not poor), municipal employees, and the middle-class recipients of municipal services.

A second problem is that some groups (government employees, for example) receive such a high proportion of their total income from government that an across-the-board reduction in its size or function would cause them a net loss. Most citizens, of course, would experience a net gain, any loss in benefits being offset by a reduction in taxes and monopolistic prices. Unfortunately no significant portion of the taxes an individual pays is allocable to one particular program, just as no significant portion of a product's price is visibly caused by the Interstate Commerce Commission. As a result, few individuals perceive that the particular programs which benefit them are a significant cause of high tax rates, inflation, or government size, or, conversely, that elimination of those programs would significantly reduce their taxes.

What voters *may* instinctively understand is that the elimination of programs which specifically benefit them will reduce taxes and government *only* when combined with the elimination of a number of others which do not. But the political system does not offer such voters a way to ensure in advance that enough other programs will in fact be terminated so as to leave them with a net gain. Enactment of such a reform depends upon the acts of several hundred legislators and a President—as well as upon public opinion on other issues that are competing for attention—so that no candidate for any office can guarantee the outcome. Voters thus understandably fear that acts of self-abnegation will not be reciprocated and that they will lose their benefits while continuing to suffer under the burden of heavy taxes. When it comes to reducing government, therefore, the voters' quite reasonable response is, "After you."

Electoral campaigns and legislative behavior are profoundly affected by this phenome-

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non. Many candidates adopt the general rhetoric of diminished government (but only for programs that do not benefit strategically located constituents), promise greater specific benefits than ever to these constituents, and deliver on this promise by acquiescing in legislative log-rolling—which continues to increase government expenditures. Both Mr. Carter and Mr. Ford vied with each other to be "anti-Washington" but both made it clear to key groups in the electorate that they could count on federal help.

The lesson taught our citizenry by welfare state politics is not compassion but selfishness, the view that if one group, no matter what its ideological orientation, does not grab its "share" from government, another will. This competition may lead to an array of claims for government support that is impossible to satisfy fiscally, yet impossible to deny politically. In such circumstances, political campaigns become surrealistic rituals. Thus, the recent Democratic mayoral primary in New York City found the candidates obsessed (and gratefully so) with the death penalty issue, over which the mayor has neither power nor responsibility.

Voter behavior is also affected. Policy issues have declined in importance as the skill of a congressman in facilitating the delivery of government benefits has increased. This phenomenon, along with others, has resulted in an extremely high rate of electoral success for incumbents. On policy issues, therefore, American voters are in the midst of an identity crisis. Philosophically they apparently want less government, but they cannot find a realistic way of bringing that result about. Why should they not feel that elections are increasingly irrelevant?

There is a tipping point at which the breadth of welfare state benefits is sufficient to impair the capacity of government to reverse the trend toward more taxes, rising inflation, and greater size, even though a large majority of the citizenry may actually desire such a reversal. At this point, governmental paralysis may result.

Persistent inflation is evidence of a paralysis over the choice between the conflicting pressures to lower taxes and to raise expenditures. Inflation is chronic in the omnipresent welfare state, partly because printing money is politically less visible than a direct reduction in government expenditures or a direct increase in taxes. Inflation of course is a compromise, since it reduces the value of expenditures and increases the taxes paid, particularly if taxpayers are moved into higher tax brackets. But chronic inflation is a painful compromise and it is not surprising that it may cause a loss of confidence in the political process.

Another feature of our welfare state contributes to the feeling that electoral politics are irrelevant. A welfare state that extends its bounty beyond the genuinely poor and dispenses services as well as money requires a large and complex bureaucracy to administer it. This bureaucracy in turn reduces the relative power of the elected branches of government. Many of our social and economic programs entail a delegation of power to non-elected officials who are able thereafter to make law on their own. This essentially legislative power in many ways exceeds that of the Congress, although rarely are the actions of the bureaucracy subject to the kind of prolonged and searching debate that precedes—or should precede—major legislative acts.

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Although the welfare state bureaucracy is not democratically responsive, each component of that bureaucracy tends to view itself as a representative of a particular interest group. Thus, the Department of Agriculture acts as a representative of farmers, those who administer the Davis-Bacon Act regard their constituents to be the construction unions, and the Equal Employment Opportunity Commission views minority groups as its principal constituency. All concerned, whether they benefit or suffer from acts of the bureaucracy, tend to regard *it*—rather than the Congress and the electoral process—as the focus of the political struggle over a number of critical issues. This must account in part for the paradox that the more the government is involved in our lives, the less relevant elections seem, a mood which is clearly anti-democratic.

For example, the quota issue is a fundamental question, going to the very heart of the kind of society we want to be. We have, however, without legislative act or significant public debate, begun to impose racial and sexual quotas on employers and educational institutions through the acts of the welfare state bureaucracy. Those who favor such measures view it as standard operating procedure to seek them through administrative decision. Those who oppose such measures believe their remedy is in the courts, which are also outside the electoral process. The elected branches are regarded by all as so irrelevant that the issue of quotas was hardly mentioned in the recent campaign. Indeed, the first considered formal statement by President Carter on the matter appears to be the Department of Justice's amicus brief in the *Bakke* case. That few regard this situation even as odd underlines how accustomed we are growing to anti-democratic government.

MY ARGUMENT, of course, is subject to an important qualification. At bottom it rests on the proposition that voters, acting rationally in their economic self-interest, will cause government size and expenditures to grow. But voters may react to a variety of interests, some of which may countervail the economic. War, for example, popular or unpopular, may transcend all other issues, just as appeals to nationalism can generate major economic sacrifices. So too voters may become sickened at the sight of their government's abusing its taxing power to serve as a grab bag for those who are politically able to carry away the most. A consensus might develop that called upon government to protect only against genuine deprivation and catastrophic loss and rejected the idea that the present size of government is necessary in the name of compassion.

If so, the immediate step must be to limit all new programs—and, where possible, to divert the old—to alleviating genuine deprivation. In fulfilling that responsibility, we should, where possible, make cash grants to individuals rather than undertake to deliver services. Not only would that be cheaper but it would avoid much of the threat to democratic rule arising from the delegation of legislative power to a bureaucracy. Government grants, moreover, should not be conditioned on the recipient's adhering to any regulation not specifically authorized by legislation. Progressive income-tax brackets should be indexed according to cost-of-living changes so that government's profit from inflation is reduced.

Finally, there is a method, unique to a nation with a written constitution, by which the "after you" response to calls for reducing the size of government can be muted. Constitutional amendments can provide assurances that a reduction in one voter's benefits will be reciprocated by others, so that all benefit. Unlike the election of representatives, the amending process permits binding commitments by all to particular policies, an "all together, now" instead of "after you" approach. There is not the space here to discuss the details or appraise the kinds of amendments that might be appropriate. Among the species, however, is the proposal to set a limit on government expenditures as a percentage of gross national product. These matters are complex but worthy of far more attention than they have received in light of the impact of welfare state politics on the responsiveness of democratic political processes.

SUCH MEASURES seem drastic. In truth, they would merely stabilize the present situation and end the spiral of taxes, inflation, and government expenditures. Those who dismiss them out of hand have an obligation to offer something other than more of the same and a further obligation to tell us how else we can reverse the present drift away from democracy. ■

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WILL LAWYERING STRANGLE DEMOCRATIC CAPITALISM?

Laurence H. Silberman

THE LEGAL PROCESS is essentially the adversary procedure by which we interpret, apply, and sometimes create law. And what we call the "rule of law" is indispensable to the very existence of both capitalism and democracy. For capitalism cannot develop unless private property is, at least to some degree, protected against private assault and arbitrary governmental confiscation. Indeed, as Paul Johnson emphasizes (*Enemies of Society*), the development of the "rule of law" in England gave that country an advantage over its European competitors and therefore explains why the Industrial Revolution developed first in the British Isles. Similarly, democracy, the only form of government that legitimates and even institutionalizes dissent, requires legal support for peaceful political activity—free speech, free assembly, a free press, and the rest—without which dissent cannot flourish. That said, it is also true that the legal process, because of its unbridled growth, has become a cancer which threatens the vitality of our forms of capitalism and democracy.[1]

Capitalism, of course, is based on private, market-oriented decision-making, whereas the legal process, although it normally takes the form of an adversary proceeding in which private interests play their part, is in reality a way in which the government asserts power. Today, there is an increasing awareness in the industrial democracies that a certain degree—a tipping point if you will—of governmental intervention into the workings of the economy begins to erode the natural vigor of capitalism. Reliance on the legal process contributes to the sum total of governmental intervention and thereby endangers our economy.

Democracy is also threatened because it obviously depends on a government that responds, at least over time, to popular majority will. The legal process is a form of governmental decision-making in which those who decide (adjudicate) are, to a greater or lesser extent, removed from politics—which is another way of saying they are not responsive to popular will. As already noted, certain protections *against* the democratic political process are needed in order to ensure the very functioning of democracy, but the growing use of the legal process eventually erodes the vigor of other governmental institutions directly responsive to the populace, and thereby the health of democracy itself.

By legal process I mean to include not only court proceedings but also the activities of the entire panoply of tribunals that have proliferated in the United States in recent

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[1] It is fashionable today to describe the American economy as "mixed," a not very descriptive term employed to avoid giving positive value to the private sector. Since I, unabashedly, assert that value, I prefer "modified capitalism"—a term which raises the issue how much modification capitalism can take without losing its acknowledged virtues. It is, however, with acceptance of its modified character that I use the word capitalism throughout.

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years. Some commentators focus concern on the growth of litigation in the United States; others decry the regulatory explosion. But actually those two trends are interrelated and complementary. Certain regulatory agencies adjudicate in what has come to be called a quasi-judicial fashion, others litigate before courts, and most do both. But even when adjudicatory authority is given to a regulatory agency, the courts are always granted authority to review agency decisions (under a greater or lesser scope of review). In other situations jurisdiction to rule on particular issues is given to, or asserted by, the courts directly. In either event, the common link is the displacement of private and political decision-making by adjudicators, whatever their titles, to whom claims are presented in an adversary manner. This work, both the adjudication and the presentation, is normally done by lawyers.[2]

That an adversary procedure is used is fundamental to the expansion of the legal process. If our jurisprudence grew out of an inquisitional tradition—in which judges openly supervised inquiry—it would be much more apparent, and perhaps less tolerable, that the legal process was gaining such power. In a sense the adversary procedure disguises that trend because it deceptively suggests a neutral umpire-like role on the part of adjudicators and merely an advocates' role for the lawyers.

Although the legal process is distinctly adversary, it is by no means uniquely so; all societies devise forms to respond to and channel the adversary or competitive nature of man. Our government, our Constitution, was devised in accordance with the notion that an adversary political clash of various conflicting economic, social, and sectional interests was the best protection against the dominance of any group or class. That concept implicitly assumed that no one economic or social interest was morally superior to the rest—although, as Madison put it, "a coalition of a majority of the whole society could seldom take place on any other principles than those of justice and the general good." The successful coalition of interests—these coalitions inevitably become political parties—would be the one that could attract the greatest number of votes. The legal process, however, is a quite different sort of adversary proceeding because the winner or prevailing interest is the one deemed to have the "better" position in accordance with a legal-moral standard.

Capitalism and democracy, in common, stand for competition for the allegiance of the public as either consumers or voters. The legal process, on the other hand, is fundamentally antithetical to *both* because the competition is for the ear of a government official who will determine the *superior* claim among litigants, usually, as discussed later, in terms of priority of rights.

I

This century has seen enormous governmental growth in all the industrial democracies, ostensibly in pursuit of greater equality of condition. But direct government control of the economy (public ownership of production), although common in Western Europe, has never been attractive to Americans, perhaps because of a residual distrust of governmental tyranny. Moreover, our constitutional system makes the direct accretion of governmental power more difficult here than in any other democracy. The Constitution, of course, grants certain authority directly to the President and the judiciary, but the primary method contemplated whereby the government gains new authority is legislation (the secondary one being constitutional amendment). And legislation requires not only a majority vote of the two separate houses of the Congress but also either the assent of an independent executive or a two-thirds vote of both houses to override the executive's veto. Naturally, the more difficult

[2] Not all American lawyers are directly engaged in litigation, although with the growth of administrative regulatory agencies and the enormous increase in federal and state court proceedings, litigation work is growing much more rapidly than counseling. In any event, legal counseling as opposed to business counseling, which some lawyers do, is always shaped and directed by the prospect of litigation. Moreover, that many, even most, legal controversies are settled after or before suit is actually filed does not detract from the growing reliance on the legal process. Since these negotiated settlements are reached in accordance with lawyers' views on the probable results of litigation, they actually extend the adjudicators' impact. Thus, the relevant question is: what is the rate of transference of controversies into legal disputes? My own guess—the rate would be virtually impossible to measure—is that it follows closely the rate of increase in actual litigated cases or, for that matter, in the number of lawyers.

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the legislative process, the easier it is for a determined minority to block passage. Therefore, in the United States, as opposed to the parliamentary democracies, legislation has usually required a fairly broad national consensus.

Not surprisingly then, those in this country who wish to increase governmental power are led to seek it indirectly, and less obviously, through the legal process. So long as inducing judges to rule on complicated social and economic issues is easier than getting bills through Congress, judge-made law is preferable to legislation.

That Americans rely so heavily on the legal process is not totally a new phenomenon; Tocqueville noted this peculiarity of American democracy over 130 years ago. Still, until relatively recently the prevailing view among lawyers, law professors, and judges—mindful as they were of the undemocratic nature of the legal process—was the need for judicial self-restraint. Judges were not to make policy; their authority derived only from the necessity to settle, in accordance with law, disputes between private parties that could not be settled elsewhere.

In the 1930s the acceptance of this judicial limitation led to the creation of a score of independent regulatory agencies. Those who wished to extend governmental power through the legal process but were reluctant to openly grant policy-making authority to judges turned to the concept of an independent agency which, because of its quasi-legislative character and supposed expertise, was thought more appropriate for this role. These tribunals—which Charles L. Schultze, chairman of the Council of Economic Advisers, calls command-and-control modules—engage in lawmaking, but it usually is a peculiar kind of lawmaking in which the extent of policy discretion is often disguised by the use of a form of legal adversary procedure to present alternative arguments and supporting information to those who decide. This procedure suggests mere statutory interpretation rather than creation of policy. Some of these agencies, like the National Labor Relations Board, are still reluctant to issue rules rather than enunciate policy at the end point of litigation because adjudication is even less obviously policy-making than rulemaking.

Paradoxically, after the creation of so many of these regulatory agencies, judges, eschewing concepts of judicial self-restraint, began more assertively to set policy themselves. Appellate review of agency decisions, initially quite restrictive, expanded as judges became more assured of their own policy judgments. Even more striking was the expansion of original jurisdiction to cover disputes not traditionally thought appropriate for judicial scrutiny, and the new ease with which litigants gained access to judges.

One hundred years ago litigation was a very chancy business. Rules of court were encrusted with arcane tradition, and a technical mistake in pleading could destroy a cause of action. Trial itself carried almost unforeseeable risks. In those days one did not lightly go to court. But reform came—the reformers asserting the need to bring courts into the twentieth century; litigation was simplified and much of the gamesmanship eliminated. Thus, in the 1930s discovery procedures designed to minimize surprise at trial were introduced into the federal courts.[3] Significantly, these procedures greatly expanded the information available to judges inclined to broaden the reach of judicial decisions.

More recently we have seen the erosion of doctrines by which judges once limited their own jurisdiction. The avoidance of political questions, the requirement that a dispute be justiciable and ripe, the insistence that a party to a cause have standing (a sufficiently direct interest in the dispute)—these doctrines and many others have washed away before the flood of petitions for judicial intervention and, by disappearing, have encouraged more petitions.

Indeed, with the rise of public interest law firms of both Left and Right, devoted to the advancement of scores of political causes, lawyers today increasingly represent these causes rather than parties before the courts. The expansion of class actions has reached the point where the plaintiff is more fictional than real (Nathan Glazer speaks of the phantom plaintiff) and, with the liberal award of attorney's fees, it may soon be possible to do without litigants altogether (so long as the

[3] Discovery procedures include both oral (depositions) and written (interrogatories) pre-trial questioning as well as demands for production of documents. The scope of permissible pre-trial inquiry is much broader than that which governs trial itself.

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court finds a target for judgment).

As the courts became more and more accessible and as judges unashamedly reached for policy, the judiciary constituted an even more attractive force for political and social change than the administrative agencies. Ironically, it was once thought that judicial review would hold agency activism to congressionally designed parameters. Today, it is difficult for many agencies to catch up with the pace of judicial activism. Even ambitious civil rights enforcement agencies have been continually challenged by the speed with which courts discovered new meanings in the Constitution and in recent (as well as nineteenth-century) statutes, thereby tending to convert anti-discrimination law into a grand racial or ethnic proportional representation scheme.

II

The growth of the legal process is not occurring without the wholehearted support of a good portion of the American intelligentsia. Those who fundamentally distrust choices made by the population as a whole, in both economic and political spheres, wish to divert as many issues as possible to the legal process. The first step in this transference is to describe an interest as a right. Once that is accepted, it is only a matter of time before courts assert authority to define and protect the right. (As Nathan Glazer points out, in protecting rights courts feel impelled to go to the "root of the problem"—which inevitably results in courts' issuing detailed administrative decisions.) A right is, after all, a priority that the holder can assert against adversary interests—even when those adversary interests are in the majority—because a right is perceived as having a superior moral claim to other interests. Certain rights constitutionally granted are virtually absolute priorities against all comers; others are of a lower order of priority. But all rights are to be protected by those institutions in our society—courts and other tribunals—that are empowered to stand against democratic will. A right, then, is a grant of jurisdiction to the legal process.

We have come a long way since Thomas Jefferson listed as unalienable rights life, liberty, and the pursuit of happiness.[4] The Constitution, particularly its amendments, guarantees the essence of those legal rules that I have described as required by democratic capitalism. But new rights are constantly asserted and judicially recognized. Obviously, every new right so recognized reduces the scope for both private decision-making and the political process. What Peter Berger and Richard Neuhaus call mediating structures — families, churches, schools, corporations, labor unions, and political parties—because they stand between government and the individual (and which I prefer to call intermediate institutions since they should *not* be thought of as owing their legitimacy to any function performed for government) are, without question, indispensable pillars of a pluralistic democracy. Yet, their capacity to manage their own affairs is continually challenged—most often with respect to the crucial matter of internal discipline—by the creation of new individual rights antagonistic to institutional rights. In this profusion only the legal process benefits; its sway continuously expands.

Currently it is fashionable to speak of every American's right to a job. The government should be obliged, according to some, to provide employment (a "meaningful" job at a "decent" wage) to all those who cannot find such in the market. Make no mistake, advocates of this notion well understand the institutional significance of couching it in terms of right; an early draft of the Humphrey-Hawkins bill actually provided for judicial recourse to those who would assert the right. It is hard to imagine a question more central to the political process in this or any other industrial democracy than the relationship between inflation

Perhaps, now that courts administer prisons, schools, [and] hospitals, . . . it is time for judges to assume the challenge of macroeconomics. Nevertheless, we should clearly understand what a raid on democracy this rights-creation business really is.

[4] Jefferson notwithstanding, Ronald Dworkin in *Taking Rights Seriously* (Cambridge, Mass.: Harvard University Press, 1977) argues that there is no general right to liberty—essentially because you cannot plead it in a complaint.

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and unemployment. To allow unemployed Americans to sue the government and assert their priority for employment would be to give judges authority over that central issue. Perhaps, now that courts administer prisons, schools, hospitals, even large portions of state governments, it is time for judges to assume the challenge of macroeconomics. Nevertheless, we should clearly understand what a raid on democracy this rights-creation business really is.

III

Who are the beneficiaries of this trend? Most directly, American lawyers who profit by the increased business and from whose ranks the judges and agency heads are drawn. They share a community of interest with the intelligentsia who wish greater governmental growth and with the bureaucracy that staffs the government agencies. Indeed, the "new class"—the term Irving Kristol and others use to describe those academics who, along with the bureaucracy, stimulate governmental growth (in large part for the power it bestows on its sponsors)—has formed a triple alliance, private lawyers being the third ally. So long as the path of governmental expansion is in the direction of the legal process, most lawyers will support the alliance's goals. Even lawyers who philosophically oppose governmental expansion are understandably somewhat mollified when it takes familiar and profitable forms. This is not to suggest they are greedy, only human.

Perhaps it is inevitable that those who train for law school reflect attitudes consistent with self-interest. Still it was not always true, at least not to the present extent; law faculties at one time were heavily staffed, if not dominated, by professors who brooded over the anti-democratic character of the legal process and therefore impressed upon their students the need for its cautious use. Now it seems that law schools are centers of distrust for capitalism (and contempt for businessmen) as well as impatience with democratic institutions.

One reason for the antipathy to capitalism that marks so many American lawyers and law students is their tendency to think of the legal process as outside, or unrelated to, economics. The phrase "everyone is entitled to his day in court" tacitly implies that litigation is essentially a free service. Of course, lawyers recognize the reality of legal fees, but most are unconcerned with the full costs of the legal process and therefore are normally instinctively hostile to suggestions for dealing with social problems that do not rely on the legal process.

Thus, the characteristic lawyers' response to the legal problems of the poor is not to attack those problems directly, but rather to provide lawyers at public expense. That family disputes and automobile accident claims, for instance, are disposed of through elaborate adversary legal procedures is a costly national scandal. But lawyers expiate any feelings of responsibility by supporting free legal services for needy individuals, thereby conveniently ignoring the total costs of this litigation, which inevitably, in one form or another, are passed on to society.

The economists, whose methodology calls attention to all costs and employs the concept of trade-offs, are particularly aggravating to most lawyers because they constantly threaten to prick that balloon of legal illusion (even though trade-offs, the stuff of compromise, fit neatly with the democratic political process). Recently, Charles Schultze, calling for a change in the federal occupational safety and health program, proposed that government-created incentives and disincentives would promote worker safety and health more effectively than thou-shalt-not rules. Schultze was greeted by a tumultuous outcry from lawyers in the bureaucracy, the Congress, and the public interest law firms. Why? Because his proposal, as the critics put it, would place an economic value on human life. Of course the present regulatory system, despite protests to the contrary, cannot avoid at least implicitly balancing regulatory costs with the increased health and safety benefits to be achieved. So long, however, as this process is never explicit, the illusion of a free legal process can be perpetuated. The sad truth is that Schultze's proposal engendered such hostility not because it placed an economic value on human life but because it placed an economic value on the legal process.

The sheer number of American lawyers—their ranks augmented by a staggering annual influx from our law schools—stimulates the

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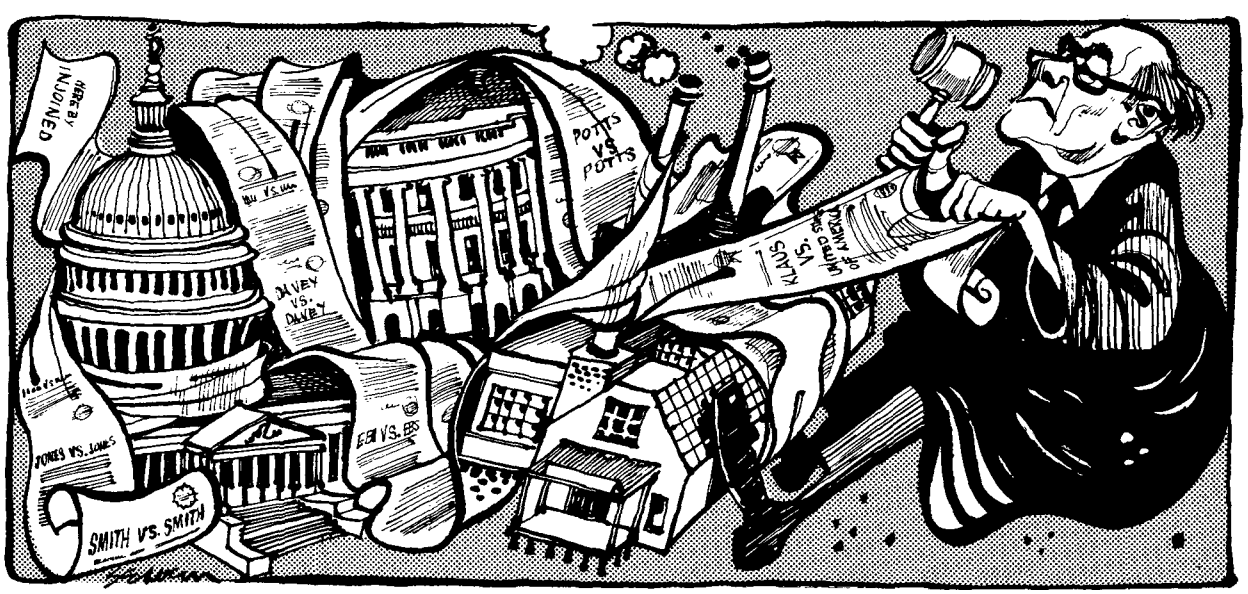
prodigious growth of the legal process. There is an ancient story, which lawyers love to tell, of the small town lawyer who almost starved until another lawyer moved to town—at which point they both waxed prosperous. The story tells us a great deal; it is really about a variation of Say's law, which preceded Lord Keynes's emphasis on demand management: an increase in supply (in our case, the supply of lawyers) creates an increase in demand.[5] This trend is helped along by the manner in which lawyers—because of their relative mobility and the obvious direct returns to their professional interests—pursue elective office. Since lawyers dominate the Congress (and state legislatures), legislative recourse to the legal process to resolve problems is virtually inevitable.

Of equal concern, however, is the percentage of our very best talent that is drawn into law rather than business. Undergraduate professors are struck by this trend and examination of the legal registers that list academic honors confirms it. Interestingly, a Yugoslav economist recently expressed concern to me about the number of that country's finest graduates who were avoiding business enterprises (because of recent ideological trends) and, instead, choosing safer government bureaucratic jobs. His nation's productivity would, he thought, inevitably suffer. In the United States it is not the bureaucracy that attracts a disproportionate share of our talent. It is the legal profession, and lawyers today are more and more simply a structural continuation of the bureaucracy. As the regulatory portion of the legal process has grown, lawyers—particularly those concentrated in urban centers—increasingly function as intermediaries between the regulatory agency/judicial complex and the regulated targets. They mold the multiplicity of legal rules through the legal process so that they fit snugly around American corporations, unions, and other institutions. If we drastically reduced the nation's private lawyers, there would be an inevitable push to increase the number of bureaucrats. Otherwise the government's capacity to dominate our society would be threatened.

Ironically, we see that the market works, even for those who challenge it: talent is drawn into law because that increasingly is where the power is (as well as handsome economic rewards). Disdain for capitalism and capitalists, elitism couched in Naderite concern for consumers and the poor, impatience with the democratic process as an inadequate engine for social change—all follow from the power afforded those who join the ministers of the legal process. They respond to the prospect not of the rule of law, but of the rule of lawyers.

[5] If I am correct in this application of Say's law, attacks on legal profession entry limitations and advertising restrictions may be misguided. The economy as a whole might be better off if we considerably toughened bar examinations and thereby reduced the number of practicing lawyers, as well as tightened, rather than loosened, advertising restrictions.



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IV

Recently, a corporate executive amused an audience of lawyers by describing his corporation's annual earnings as seven times legal fees. Attorneys' hourly rates have, of course, increased—but probably no faster than other costs in an inflationary age.[6] The real direct cost increase is in the proliferation of legal services. One finds an analogy in medical care, where sky-rocketing costs are attributable not so much to increased doctors' fees as to the widespread use of sophisticated machinery and "pioneering" medical services, including surgery, with only marginal utility (stimulated, according to many economists, by extensive "free" insurance coverage—which should give pause to those who advocate the spread of employer-financed prepaid legal insurance plans). In any event, the direct costs are probably dwarfed by indirect costs; every piece of litigation diverts hundreds, in some cases even thousands, of non-legal personnel from productive work. And the charge upon the creative energy of senior executives—the most valuable asset any business enterprise enjoys—is surely the most serious cost of all.

In a capitalist economy, efficiency and, therefore, productivity depend quite clearly on speed of response to changing market conditions. The legal process importantly delays both the making of decisions (the willingness to take risks), because it introduces external imponderables, and the carrying out of decisions already made. In truth, litigation of all kinds is becoming a major structural impediment to our economy. This is most dramatically apparent in the energy field where nuclear power plants, the Alaskan pipeline, and offshore oil exploration have been delayed interminably to the detriment of our national economy while judges ponder issues beyond their ken. But there is virtually no business investment contemplated today that is not to a greater or lesser extent surrounded by legal process snares. Naturally then, the willingness to risk capital is diminished and economic growth suffers. Indeed, perhaps some measure of the competitive advantage that Japan and some European nations seem to enjoy vis-à-vis the United States is attributable to their much less intrusive use of lawyers.[7]

If the impact of the legal process threatens the vitality and growth of our economy, it is no less a problem for our democratic institutions. As discussed before, our Constitution grudgingly permits accretions of government power: legislation requires a dominant consensus. And the need for consensus stimulates compromise, thereby moderating intolerance of opposing views. The legal process, on the other hand, offers the prospect of victory without compromise (which is what makes it so attractive to those who see moral imperatives in the satisfaction of proliferating rights). As the legal process becomes the favored procedure for resolving issues, the ability of legislative institutions to forge compromises that truly resolve contentious issues is lost.

I do not mean to ignore the executive branch. The President, uniquely responsive to the entire popular will, once had great policy latitude over the administration of the executive departments. Now, of course, much of the executive function has been diverted to independent quasi-legislative, quasi-judicial agencies. With respect to the part that remains, the executive branch is so plagued with law suits either forcing it to do what it does not wish to do or deterring it from doing what it does wish to do that it resembles, alternately, a giant puppet dancing to legal-process strings and a Gulliver tied with Lilliputian legal bindings.

We see a vicious circle. Judges apologetically say, We must decide because the Congress (or the executive) will not. However, the more apparent it becomes that the courts will at some point intercede, the less likely it is that the other two branches—particularly the Congress—will move on their own. The fundamental error is that of the judges. A lack of congressional action usually means a strong public consensus has not formed—which, in democratic theory, normally means that until it does government should not act, no matter how offensive the state of affairs to those who are "certain" of the need for a governmental

[6] Ralph Nader's recent complaint about the rise in legal fees qualifies as a new definition of "chutzpah." No one has done more to generate legal fees than this modern Torquemada who seeks to "purify" our society by using the legal process instead of the stake.

[7] West Germany has less than a quarter the lawyers per capita the United States has, Japan less than a twentieth. Great Britain, which suffers from its own brand of excessive government intervention, has only a fifth (*New York Times*, May 17, 1977).

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response.[8] It does not follow that the political process is not working merely because debate on an issue does not lead to a federal program. Discussion in news media, books, or congressional hearings could have caused people to conclude that government action was inappropriate.

Even when Congress acts today, often it is only to delegate to the judiciary—sometimes indirectly through a newly erected regulatory agency. Characteristically, the delegation is preceded by a general—often contradictory—statement of purpose that really reflects congressional abdication. It is often said that Congress's typical response to a social problem is to throw money at it in the form of a new federal grant program. That is true only half the time; the other half, Congress throws the problem to the legal process. Some argue that this trend does not threaten democratic institutions, or the Congress itself, for what the Congress creates it can abolish. It could, therefore, take back from the legal process the policy-making role which that process has acquired. Theoretically yes, but unfortunately only theoretically. The Congress is losing, or perhaps has already lost, the psychological disposition to challenge the "imperial judiciary" (to borrow Glazer's term), in part because its members see the expansion of the legal process as coming at the expense of the executive rather than themselves.

Take as an example the proposed Consumer Protection Agency. Its purpose as described by congressional adherents is to protect consumer "rights" by acting as a consumer advocate before administrative agencies and executive departments and even *against* those agencies in court. This would institutionalize the legitimacy of judicial resolution of intra-executive branch disputes, clearly resulting in an enormous shift of executive authority to the judiciary. After all, the power to resolve disputes within an organization is central to the ability to manage that organization. Less apparent but equally true, the proposal abandons the precept of congressional responsibility for setting basic policy to guide executive and independent agencies. Surely if Congress concludes that one or more of these agencies has become insensitive to public needs (presumably because captured by the regulated constituency), it has the capacity to remedy the situation directly. The truth, of course, is that Congress is split on these questions and rather than hammer out a resolution, a consensus, it finds it easier to give various "interests" an advocate and entrust the courts with the policy resolution. But each time Congress chooses this seductive approach, grappling with the next policy dispute becomes harder.

[8] This is not to be critical of the Supreme Court's decision, as opposed to its sociological theorizing, in Brown v. Board of Education. All that was necessary was to overrule Plessy v. Ferguson, the earlier "separate but equal" decision that had frustrated the purpose of post-Civil War constitutional amendments. More troubling, however, is the Court's decision in Baker v. Carr, the famous reapportionment case that propelled the judiciary into the very "political thicket" Frankfurter had predicted in the earlier Colegrove v. Green opinion. Although the Court's justification for intervention (that a mal-apportioned legislature cannot adequately respond to popular will) is a powerful one, on balance the costs of judicial intervention have outweighed the benefits. As difficult as it is for the political process to ameliorate mal-apportionment, it is even more difficult to liberate our election procedures from a judicial straightjacket.

V

The continuing shift of private and public policy formulation to the judiciary has caused discomfort as well as gratification to the nation's judges. The courts are, quite naturally, overloaded, and we hear of the need for more judges and new inferior tribunals as well as new layers of judicial review. But it is not merely the number of cases that threatens to overload judicial capacity; the size of certain cases, augmented by expanding discovery procedures, engenders talk of new reform. It is now proposed that discovery be cut back to more manageable proportions by tightening the standards of relevance.

Attorney General Griffin Bell recently horrified much of the antitrust bar by suggesting that large antitrust cases bogged down in endless discovery might be tried in Congress instead of the courts. To be sure, the suggestion cannot be taken literally—such a trial would be a circus—but the attorney general implicitly acknowledges that the appropriate forum for resolving broad economic policy questions raised by adventuresome antitrust cases is Congress, not the courts. One wishes that his antitrust division as well as the Federal Trade Com-

(*Continues on page 44*)

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GUADALAJARA! A Case Study in Regulation by Munificence

Antonin Scalia

THE STORY of the recent travail of U.S. medical schools over the requirement that they admit foreign-trained U.S. citizens to their third-year classes presents an interesting case study in the dynamics of regulation, and merits preservation as a *memento mori* for all beneficiaries of federal munificence.

The Facts

One of the concerns addressed by the Health Professions Educational Assistance Act of 1976 was the large and increasing influx of foreign-trained doctors. Statistics showed that in each year since 1970 the number of foreign medical graduates entering the country had exceeded the number of U.S. medical school graduates, that the foreign graduates constituted more than 20 percent of all physicians practicing here, and that the percentage would rise to one-third by 1990 if current trends continued. Finding that "there is no longer an insufficient number of physicians and surgeons in the United States," the 1976 act included provisions amending the immigration laws to eliminate the preference that foreign medical graduates had received. (The wisdom of this action is irrelevant here, but one must note an apparent inconsistency between the assertion that these physicians were not needed and the unquestionable fact that they readily found employment.)

Some of the foreign medical graduates, however, and even a greater proportion of the foreign medical students, are U.S. citizens. Indeed, in recent years the tide of disappointed applicants to U.S. schools has overflowed the traditional alternative schools in Western Europe (some of which no longer admit foreign students), and now reaches to more than sixty schools in more than twenty foreign countries. The Rumanian universities at Bucharest and Cluj, for example, reportedly boast almost ninety U.S. medical students; and new medical schools have sprung up in the Caribbean as an apparent market response to the Yankee student dollar. By far the largest and best-organized contingent of emigré medical students, however, is to be found at the Autonomous University of Guadalajara in Mexico.

Given the finding that there was no doctor shortage (as opposed to maldistribution) and given the criticism of foreign medical education with which the legislative history was replete, one might have expected the Health Professions Educational Assistance Act to take steps which would reduce the incentive for U.S. citizens to undertake or continue medical training abroad. In fact, however, as a result of pressure from a small but effective lobby of parents of foreign medical students, the act did just the opposite.

Each year a large number of U.S. foreign medical students (FMSs) seeks admission to the third year of American medical schools. In 1976, only 400 were successful—a relatively small proportion of the 6,000 now estimated to

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be studying abroad. The so-called "Guadalajara clause" of the act sought to compel an increase in the acceptance rate. In fact, it sought to guarantee entry into U.S. medical schools of all FMSs who had completed at least two years of study abroad and had passed Part I of the National Board of Medical Examiners' examination. This was achieved by conditioning each school's receipt of the per-student subsidies funded by the act (so-called "capitation funds," currently $1,400 per student) upon its agreement to accept a number of the qualifying FMSs to be "equitably apportion[ed]" by the secretary of health, education, and welfare (HEW). The condition was to be applicable during the academic years 1978–79, 1979–80, and 1980–81, and, the legislative history solemnly announced, would not be renewed.

The critical provision was this: a medical school whose assigned quota remained unfilled was permitted to refuse enrollment to a federally qualified FMS only if "the individual does not meet, as determined under guidelines established by the Secretary [of HEW] by regulation, the entrance requirements of the school (*other than requirements related to academic qualifications* or to place of residence)" [emphasis added]. In other words, no FMS meeting the federal requirements could be denied admission to an assigned slot remaining unfilled, no matter how unqualified academically the medical faculty might consider him to be. In practice, what was envisioned was a computerized "matching program," in which the schools and the qualifying FMSs would list their preferences, and each school would be assigned particular individuals from the pool, on what might be termed a "take-it-or-leave-the-money" basis.

This was of course an impingement upon —many would say a blatant affront to—the academic independence of the institutions affected, dictating, in effect, their admissions standards. Fourteen medical schools announced that they would not comply, and would prefer to forfeit the total of about $11 million in federal funds. (The schools were Baylor, five branches of the University of California [Davis, Irvine, Los Angeles, San Diego, and San Francisco], Case Western Reserve, the University of Chicago, Duke, the University of Illinois, Johns Hopkins, Northwestern, Stanford, and Yale.) Some schools cited financial reasons; the University of Illinois, for example, noted that providing for the additional students would cost more than the capitation funds it would receive. Most of the schools, however, expressed substantial agreement with the sentiment most forcefully voiced by Johns Hopkins, which announced that it was "not prepared to abdicate to government the right to select its students, nor for that matter, its faculty, courses of study and degree requirements."

Faced with this declination of funding by institutions that together account for some 13 percent of the medical students in the country, the Congress reconsidered the issue in 1977. The House of Representatives voted to amend the objectionable provision, the Senate to repeal it entirely. From the conference committee emerged a compromise that passed both houses and was signed into law by the President on December 19. It is, as a practical matter, substantially less onerous for the medical schools. Instead of being required to accept an indeterminate number of FMSs who pass the exam, they are merely required to expand their third-year classes by 5 percent—a much more predictable, and therefore more acceptable, imposition. The requirement is to apply for only one academic year instead of three; and the body of applicants from among whom the schools must, as a practical matter, select their 5 percent quota is expanded slightly beyond the FMSs eligible under the old law.

The Interpretation of the Facts

The Congress and the press have hailed the new provision as a vindication of academic freedom. In introducing the conference bill in the Senate, Senator Edward Kennedy (Democrat, Massachusetts) described it as "designed to restore to the Nation's medical schools the freedom to apply their own admission criteria"; and the *New York Times* concluded that the new law gives "American medical schools the right to set their own standards as to whom to admit." It may indeed work out that way, but it does nothing of the sort on its face.

To be sure, every skill known to draftsman's pen has been devoted to giving the new provision the appearance of respecting aca-

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demic independence. Thus, instead of specifying that a certain number or a certain proportion of FMSs must be admitted, the law merely requires a 5 percent increase in class size; and does not even require this quota to be filled from a particular "pool," though it does exclude certain categories of persons from counting toward the quota. It is only upon analyzing these exclusions that one discovers (of course) that there is almost no one left except FMSs who could conceivably be an acceptable applicant. The net effect of this change in statutory approach is the difference between telling a small boy that he must eat his carrots and telling him that he must eat what's on his plate. The sound is less harsh, but compliance just as unpalatable. Again, the new law carefully avoids the needlessly provocative language of the earlier version, which specifically prohibited a school from applying its requirements concerning "academic qualifications." That unfortunate phrase is never mentioned. The new version limits itself to setting forth what *will* constitute valid excuses for not meeting the quota, a list that does not include a school's academic qualification requirements. Finally, dust is thrown in the eyes of the guileless by a "good faith effort" provision, which reads as follows:

> The Secretary [of HEW] may waive . . . the requirement [of increasing the third-year class by 5 percent] for a school of medicine . . . if the Secretary determines that such school has made a good faith effort to meet the requirement . . . but has been unable to meet [it] solely because there is an insufficient number of students who are eligible to be counted in determining if the school has met such requirement.

But for the fact that it was not intended to make any sense, this provision could be criticized as not making any sense. The draftsmen evidently forgot that there is, technically, no such thing as a defined pool "eligible to be counted" towards meeting the 5 percent requirement, since, as noted above, the new law proceeded not by defining eligibility but simply by declaring ineligible almost all candidates the schools *would be likely* to admit except FMSs. Theoretically, everyone—butchers, bakers, candlestick makers—*everyone* except the relatively small number of defined ineligibles, is "eligible to be counted." It is inconceivable that this "pool" would ever be "insufficient."

Since the literal text of the provision is so devoid of meaning, it can be argued that (making due allowance for what the courts politely call "legislative inadvertence") the "good faith effort" requirement and the reference to a nonexistent standard of eligibility imply that the schools themselves are to be permitted to establish reasonable academic criteria—which may exclude not merely butchers, bakers and candlestick makers, but even some FMSs, and maybe even some FMSs who pass Part I of the exam. This interpretation is not inconsistent with the legislative history of the provision, because almost nothing is. The most pertinent portion of that history is contained in the following excerpts from the House debate on the bill, which read as though written by Lewis Carroll for Abbott and Costello:

> MR. SATTERFIELD [Democrat, Virginia]. Reading the conference report, on page 11 it says, "In the view of the managers, this enrollment increase requirement in no way impinges on the academic freedom of schools of medicine to apply their own admission criteria. . . ."
>
> I wonder if the gentleman might explain what is meant by that statement.
>
> MR. ROGERS [Democrat, Florida, floor manager of the bill]. Well, . . . we are asking that they increase their enrollment a certain percentage in the third year. Their admission policies are left up to the schools. . . .
>
> MR. SATTERFIELD. I invite the gentleman's attention to . . . the bottom of page 10, where it says, "The conferees do not intend the additional waiver authority to be used for schools who simply apply their normal admissions standards and find no student eligible to be counted can meet such standards."
>
> In other words, reading those two together, it would seem to me that we are saying that if a school applies its normal admission standards and there are not enough people available to fill the quota, then the school has to lower those standards in order to meet the quota. Am I correct?
>
> MR. ROGERS. What we are saying there is that we do not expect them to manufacture unusual conditions to try to avoid the requirement of the law to increase 5 percent in the third year. For example, if a school attempted to apply its first year require-

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ments to the third year class, that would, in my view, not constitute a basis for a waiver.

MR. SATTERFIELD. If they apply their normal admission standards, I would not think that would be unusual action.

MR. ROGERS. It depends. And, also, the normal admission might not even include a 5 percent increase.

MR. SATTERFIELD. That is the point. In other words, you make the 5 percent quota, and if your normal admission standards are too stringent to provide that 5 percent, you must fulfill your quota by reducing your standards?

MR. ROGERS. No. What we are saying is that we expect a group of students who qualify to be considered. They must be the normal, fair standards of the school. But we do not expect them to manufacture unusual standards or make a standard so high that they are able to say that, "We are not able to take 5 percent." . . .

MR. SATTERFIELD. I invite the gentleman's attention to the waiver provision. According to the report, it says that the Secretary may grant a waiver if he determines that the school has made a good-faith effort to meet the requirements but that there are not enough students eligible to be counted.

I am a little puzzled by the meaning of that, in light of the two provisions I just read.

MR. ROGERS. This is what we are trying to say— . . . that, if they make a good-faith effort in accepting the student under the 5 percent requirement, that is what is required. If there is an insufficient number of students eligible to be counted, then—and only then —would this particular provision attach. . . .

MR. SATTERFIELD. Then . . . I am to conclude that a school which applies its normal admission standards that it has applied through the years would not be making a good-faith effort?

MR. ROGERS. No. Normal admission standards might be that they do not admit students in their third year.

If they make a good-faith effort under the law, a good-faith effort but the total group eligible to be counted is not sufficient, and thus a school simply cannot get enough students, it would be entitled to get the waiver.

MR. SATTERFIELD. You emphasize the word "normally," am I to understand then that the word "normal" really does not apply to academic standards.

MR. ROGERS. It could, because if they make an artificial academic standard in order to simply avoid the requirement they also would be blocking what we are trying to do, to get them to increase class size in the third year by 5 percent.

MR. SATTERFIELD. Would a school, then, which applies its normal academic admission standards . . . be exercising good faith?

MR. ROGERS. If it is not blocking the 5 percent increase.

MR. SATTERFIELD. In other words, the 5 percent controls, and if you cannot reach the 5 percent with your normal academic standards, you have to reduce them in order to reach the quota?

MR. ROGERS. Not necessarily. If they make a good-faith effort but there is an insufficient pool, they are entitled to a waiver.

MR. SATTERFIELD. I thank the gentleman.

There was of course no reason for the gentleman from Virginia to thank the gentleman from Florida, since the matter under discussion had skillfully been left in the same degree of obscurity it enjoyed when the exchange began. Beyond vigorously affirming the obvious points that a school which intentionally increases its normal standards in order to avoid taking the 5 percent *is* in violation, and that a school which, in applying its normal standards, admits the 5 percent is *not* in violation, Mr. Rogers had said nothing. Mr. Whitten (Democrat, Mississippi) was no more successful in pinning the matter down:

MR. WHITTEN. The gentleman is saying what we do not count on [the schools'] doing. Would the gentleman tell us what we do count on their doing?

MR. ROGERS. To obey the law and admit 5 percent of the people who are qualified to be counted.

MR. WHITTEN. What is the meaning of "good faith"?

MR. ROGERS. . . . It is exactly that, good faith in carrying out the law.

MR. WHITTEN. And the law is what?

MR. ROGERS. The law is that they shall admit 5 percent of qualified students based on the admissions criteria of that particular school.

MR. WHITTEN. So the "good faith" matter is just a come-on for doing as they wish?

MR. ROGERS. Not at all. It is to let them out if they have made a good faith effort, and an insufficient number of eligible students are available such that the school is unable to comply.

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The rest of the discussion is no more illuminating.

I have gone into the House floor discussion at such length (there was no Senate floor discussion) in order to bring home to the reader the important truth that the provision in question not only is unclear, *but was meant to be unclear*. Judging from the floor debate, "good faith" does not mean the mere impartial application of bona fide academic standards designed without specific intent to sabotage the law—for otherwise the use of first-year standards would not be automatically invalid. Yet, apparently, "good faith" also does not mean the establishment of qualifications low enough to ensure that the quota is met. But what else is there between these two extremes? Nothing, of course, with any precision; only a vague idea that the schools are expected to bend a bit to help the law achieve its purpose.

There is one point, however, on which the statute and the legislative history *are* clear:

> MR. WHITTEN. . . . I asked a simple question: Who will determine whether it is good faith or not?
>
> MR. ROGERS. The Secretary of HEW.
>
> MR. WHITTEN. Which leaves it in the hands of the Secretary of HEW to do whatever he pleases; is that correct?
>
> MR. ROGERS. No.
>
> MR. WHITTEN. Is it not based on his determination?
>
> MR. ROGERS. Not entirely.
>
> MR. WHITTEN. All right, what is the limitation?
>
> MR. ROGERS. The schools must show that they have made a good faith effort and that an insufficient number of eligible students are available. . . .
>
> MR. WHITTEN. To whom do they have to show it? Who makes the determination?
>
> MR. ROGERS. The Secretary.
>
> MR. WHITTEN. So the Secretary, in the final analysis, can say, "Yes" in this case and "No" in that case; and we have no guidelines pursuant to which he must act; is that correct?
>
> MR. ROGERS. Who else is to determine it? Is a school to determine whether it has made a good faith effort?
>
> MR. WHITTEN. That is the point. . . . The gentleman says that the Secretary will determine it to suit himself?
>
> MR. ROGERS. This has always been done, as the gentleman knows. . . .

The Significance of the Facts

The saga of the Guadalajara clause is of immediate practical importance to medical school faculties and, in a somewhat lesser degree, to all of us associated with universities. For a number of reasons, it is also immensely instructive to those who are interested in the phenomenon of expanding federal regulation —and in particular that species of federal regulation which is characterized by broad discretionary authority in an executive agency.

Given the vagueness (not to say impenetrability) of the statutory language and the First Amendment overtones of the issue, it is possible that the courts will require the secretary of HEW to grant a waiver to any school that fails to meet its quota because it has applied genuine academic standards (other than extension of first-year standards to the third year). Whatever the outcome of the ultimate court test, however, it is clear that the first stretch of the long legal road for the medical schools will consist of the now familiar process of negotiation, ultimatum, and compromise with a Department of HEW that applies standards and criteria uninformed by any statutory guidance. And it is further clear that—despite the lawmakers' now ritual condemnation of agency arbitrariness and power—this is precisely what the Congress intended. Simply put, the members could not reconcile their differences, and so they adopted a provision that is quite literally meaningless, enabling both sides to claim victory and leaving it to HEW (and, if they wish to intervene, the courts) to sort out the pieces.

The advocates of broad delegation of discretionary authority to the agencies almost invariably base their case upon the sheer lack of time which the Congress has to devote its attention to the minute details of regulation. Increasingly in recent years, however, the genuine occasion for delegation has been not the absence of congressional time but, after the expenditure of congressional time, the absence of congressional agreement. The Guadalajara clause episode may not be typical, but it is far from the rare exception. Whatever one might think of broad delegation as a general matter, delegation with what might be termed acknowledged absence of congressional agreement is a deplorable distortion of democratic

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processes. With the ordinary broad delegation, there is at least a genuinely assumed social consensus which it is the task of the agency to translate into specific detail. Delegation in acknowledged absence of agreement, on the other hand, intentionally confers upon the agencies or the courts that function of reconciling or subordinating conflicting private interests which is preeminently the task of the political branch.

. . . delegation with what might be termed acknowledged absence of congressional agreement is a deplorable distortion of democratic processes.

Another interesting feature of the Guadalajara clause saga—perhaps the most interesting feature from a "human interest" standpoint—is its David and Goliath character. The groups whose interests were infringed by the provision were surely substantial—all of the nation's medical schools and, more broadly, the entire medical and university establishment. Moreover, they had on their side what would normally be a most inspiring rallying call for liberals and conservatives alike—academic freedom and the First Amendment. Arrayed against them was a lobby consisting almost entirely of the families of no more than 3,000 first- and second-year FMSs, the vast majority of whom were said to be from three states (New York, New Jersey, and California) —undoubtedly an affluent and politically influential group, but hardly formidable. Their cause, moreover, not only had none of the high tone of academic freedom and the First Amendment, but could scarcely be dressed in any cloth more noble than self-interest—or at most mother-love. Nonetheless, the FMSs won the first round completely, and managed to retain much in the rematch. The latter, of course (that is, their success in fighting off outright repeal), can be explained by a combination of (1) the sense in the Congress that the FMSs who are already in their second year, virtually tasting their impending admission to U.S. medical schools under the 1976 law, have something of a vested right in the continuation of that law, at least for the 1978–79 academic year; and (2) the usual human reluctance, felt in the Congress (and especially in the House, which is quintessentially human), to admit to having been 100 percent wrong.

Securing enactment of the original 1976 law, however, surely represented an amazing accomplishment. In part, it was attributable to legislative technique. The Guadalajara clause appeared in neither the House nor the Senate bill, nor even in the committee recommendation in either house; it emerged, newborn, from the House-Senate conference, leaving opponents little time to mobilize their forces, and placing them in the very difficult position of asking each house to repudiate the conference committee's work in order to repair a very small piece of the entire package. So easily can a few senators or representatives on the conference committee—or perhaps even a few staffers—if sufficiently committed to what seems to the rest a minor point, affect the entire outcome of legislation. Or at least, so easily can they do so when what is at issue is the addition of one more condition to a federal grant.

And this is perhaps the major lesson to be drawn from the story: that regulation through munificence is likely to be the most arbitrary and the most severe regulation of all. Both legally and psychologically, a condition attached to a governmental gift or benefit is easier to support than an outright governmental prescription or prohibition. Legally, for example, the government almost surely could not require all hospitals to perform abortions; but it probably could condition their receipt of federal subsidies upon their agreement to perform abortions. (This is not to say there are no unconstitutional conditions; there assuredly are, particularly when the condition bears little or no relation to the purpose of the grant or benefit, and infringes a highly protected right such as freedom of speech. But the range of unconstitutional conditions is much more limited than that of unconstitutional prescriptions or prohibitions.) Even more important than the *legal* distinction, however, is the unquestionable psychological fact that a

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legislature will not exercise as much restraint in imposing conditions upon receipt of its beneficence as it will in enacting positive law. The context, after all, is vastly altered. It is the difference between saying "Son, paint the house this weekend" and saying "Son, if you spend the weekend painting the house I'll pay for a ski trip to Aspen." Requesting a quid pro quo is quite different from laying down, without any compensation, an absolute rule. Thus it is that much of our modern social regulation has appeared first not as generally binding legal requirements, but as conditions attached to federal benefits—of which I shall say more later.

It follows, then, that the institution which has placed itself in the position of not being able to refuse federal funds has subjected itself not merely to regulation, but to regulation of a particularly intensive and relatively unrestrained sort. Most of the nation's medical schools, if not most of its universities, are already in this position. The significant statistic is not that 14 medical schools rejected federal funding under the demeaning terms of the 1976 law, but that 106 did not.

There is, moreover, another phenomenon of legislative or social psychology worth noting here—one that gives regulation by munificence a vital role in the gradual extension of regulation by law. When a condition has been attached to a governmental beneficence that is widespread (for example, to all federal contracts) or to a governmental beneficence that is, or becomes, indispensable for the particular class of recipients (for example, to renewals of broadcasting licenses), the distinction between a condition and a positive legal prescription becomes increasingly theoretical, and increasingly blurred in the public and legislative mind. What first wins acceptance only as a condition to the receipt of governmental funds or benefits eventually comes to be regarded as an appropriate provision of direct prescriptive regulation. Thus, social and legislative attitudes towards the appropriate scope of governmental prescription—and, consequently, judicial attitudes towards its constitutional limits—are continually stretched. Federal minimum wage provisions appear first as conditions to obtaining federal contracts, later as requirements binding upon the entire society; safety assurances required of federal contractors evolve into to the Occupational Safety and Health Administration; anti-discrimination conditions upon federal grants become anti-discrimination laws; the federal requirement that a broadcast licensee permit time for reply to a "personal attack" leads to state statutes which seek to apply a similar rule to newspapers. And, yes, the

. . . straight-out prescription . . . . may even have been hastened by the impudence of the fourteen schools. . . .

regulation by munificence that *all* the medical schools have been willing to endure to a substantial degree (no school balked at the capitation funding condition of the 1976 law that 50 percent of each school's residency positions be in the three so-called "primary care" specialties by the academic year 1980–81) may mutate into straight-out prescription.

Indeed, the latter event may even have been hastened by the impudence of the fourteen schools in daring to reject what the Congress thought was an offer they could not refuse. The legislators obviously were not amused, as the following excerpt from the conference committee report not too delicately demonstrates:

> The decision of several schools to forego capitation support unless the conditions for receipt were altered raises a significant question about the utility of this funding mechanism as a vehicle for accomplishing public policy objectives. Capitation support is an economic necessity for many schools. Other schools are not economically dependent on these funds. These schools would thus always retain the option of refusing capitation funds because of the attendant conditions, while the poorer schools could not afford to do so. This places the burden for implementing capitation related policies exclusively upon those schools which cannot survive without capitation support. Federal policy, however, is intended to apply to all schools.
>
> Thus the conferees have agreed to reexamine the manpower legislation early next year, and will pay particular attention to evaluating alternative approaches to the funding of medical education.

I would guess there are hard times ahead for academic freedom. ■

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Deregulating Telecommunications

Sorting Out Mixed Signals

Stanley M. Besen

We seem to be on the eve of major changes in the ways in which we communicate with one another. In the next few years, vastly expanded communication services—ranging from improved methods of information transfer between business firms to first-run movies in the home—are likely to become available. Offices may become information processing and transfer facilities, and where once there was only a television set there may be a home information center.

Along with these developments—partly their cause and partly their result—two fundamental sets of changes are taking place. One is in the structure of the telecommunications industry. The American Telegraph and Telephone Company (AT&T), having dominated point-to-point communications for years, now confronts a small army of terminal equipment and specialized communications firms competing in markets previously closed to them. And the dominance of television by advertiser-supported over-the-air broadcasters is being challenged by a nascent industry providing services over cable in return for direct payments from viewers. The other set of changes is in the regulatory environment. In a large number of important cases, the Federal Communications Commission (FCC) has relaxed barriers to entry into the telecommunications industry and, in its efforts, has had almost total support from the courts. Nevertheless, much unnecessary and undesirable regulation remains.

While predicting the future course of policy is never easy, two conclusions seem clear. First, the entry of new firms into many previously "closed" industries will continue. Second, it will be a long time before the FCC finally decides the terms on which firms may "compete" with one another. Competition will continue to be "managed" rather than "free."

Regulated Competition in the Telephone Industry

Let us first take a look at evolving FCC policy on telephone terminal equipment (telephones, switchboards, et cetera) and on specialized common-carrier services (private-line long-distance communications).

Terminal Equipment. The great watershed in the regulation of telecommunications terminal equipment supply is the FCC's decision, *In the Matter of Use of the Carterfone Device in Message Toll Telephone Service* (1968). Before this decision, AT&T's rules and those of other telephone companies forbade the "interconnection" to the telephone system of any equipment unless it was supplied (and, usually, manufactured) by the companies themselves. The basis for these restrictions was the argument that the "systemic integrity" of the telephone system required unitary responsibility for service from end-to-end. Unless a single entity controlled the entire system, it was argued, it would be difficult to assign responsibility for disruptions in service—which would

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mean that incentives to prevent disruptions would be reduced. Rules against the use of "foreign attachments" were so stringently enforced that some regulatory agencies interpreted them to exclude customer-supplied plastic covers for telephone directories and even shoulder rests for telephones.

The Carterfone was a device by which operators of private radio systems could connect their users directly to the telephone network. After some initial legal skirmishes in which the Carter Electric Company sought relief from telephone company rules by bringing a private antitrust suit, the FCC found that the rules were unreasonable as applied to the Carterfone since they failed to distinguish between attachments that posed no threat to the integrity of the system and those that did. Moreover, holding that it would be improper for this ruling to apply only to the Carterfone, the commission struck down the rules entirely. In doing so, it invited the telephone companies to establish new policies to prevent technical harm to the system without limiting the use of harmless attachments.

In response to the *Carterfone* decision, AT&T began to permit interconnection of terminal equipment manufactured by independent suppliers as long as its own "interface devices" were used with them. This policy was justified as protecting the technical integrity of the system when customers chose non-AT&T equipment, inasmuch as the devices would cause a malfunctioning piece of equipment to disconnect. One of the effects, however, was to limit severely the use of customer-supplied equipment since the price charged for using the protective devices was often greater than the savings gained by purchasing equipment from independent suppliers.

Since the promotion of new sources of equipment was a commission objective—the FCC had argued in *Carterfone* that the entry of new firms into the equipment market would encourage technological innovation—and since the rules requiring protective devices seemed to interfere with that objective, the commission has sought other ways to provide for system protection. It now permits terminal equipment certified as not potentially harmful to be employed without interface devices. While the certification program has gone more slowly than some had hoped—standards have not yet been set for some important classes of equipment—this policy, when fully carried out, will eliminate an important barrier to the entry of new firms into the industry.

In appealing the *Carterfone* decision and in the running legal battle that has ensued, the telephone companies have advanced an argument in addition to the now-rejected claim that the integrity of the system requires unitary end-to-end service and have asserted that the profits from selling terminal equipment to business users (where the threat from competitive suppliers is greatest) are needed to subsidize residential telephone rates. Thus, it is argued that if new firms are permitted to provide terminal equipment, residential rates would have to be raised.

In *Carterfone* and in a number of subsequent decisions, the FCC concerned itself almost entirely with questions of potential technical harm. Economic issues, where they were treated at all, tended to be dismissed summarily. Thus the commission stated in *Carterfone* that economic effects might well be a public interest question to be decided on the facts, but it saw no need to answer the question at that time. More recently, the commission concluded that the matter could no longer be ignored and began an inquiry into the economic effects of competition. Since the inquiry also dealt with the matter of competition from specialized carriers, we will defer the question of competitive impact until after the discussion of specialized carrier policy.

Specialized Carriers. As in the case of terminal equipment, the specialized carrier controversy began with an application by a private firm—MCI Communications—to provide a service that had previously been a near-monopoly for the telephone companies. In an earlier decision (*Allocation of Microwave Frequencies Above 890 MC*, 1959), the FCC had permitted firms to construct long-distance communications networks for their own use, but MCI was seeking permission to construct such networks to provide services to others. Like Carter Electric Company, MCI had the support of a number of business users who were unable to obtain the service they desired from existing carriers.

MCI offered to provide business users in a number of cities with private-line service (usually telephone service connecting branches

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of the same company in different cities) of a new and different type and at lower than prevailing rates. The response of the existing telephone companies was, in almost all respects, identical to the tack they took with respect to the Carterfone. Their argument was as follows: End-to-end service by a single firm was required to preserve the system's technical integrity. While MCI's proposed rates were below those of the existing telephone companies, its costs were higher. And, the only reason that MCI's prices turned out to be lower was that the telephone companies were employing the excess profits derived from providing these services to subsidize rates on ordinary long-distance telephone services and on private-line services for low-traffic routes.

Moreover, an additional issue was raised. The telephone companies argued that, if the commission permitted competition in this area, they should be able to respond by lowering prices on their private-line services to the level of their costs. The controversy surrounding the pricing of private-line telephone service had already arisen in the case of AT&T's Telpak service (AT&T's competitive response to the commission's decision to allow businesses to operate their own private-line systems). But the MCI decision permitting the entry of the new firms (*In Re Microwave Communications, Inc.*, 1969) gave special urgency to this issue.

As in the *Carterfone* case, the commission did not restrict this decision to the firm asking for the right to provide the new service. Instead, it launched an inquiry into the entire specialized carrier question, at the conclusion of which it decided to permit relatively free entry of private-line carriers (*Specialized Common Carrier Services*, 1971). According to the commission, the new firms would provide services not previously available through the telephone companies and would stimulate (indeed, already had stimulated) the companies to offer better service at lower cost.

In reaching this decision, the FCC found that the new entrants would probably capture such a small part of AT&T's market that the lost revenues would have no effect on the rates charged to other users. The commission said it would allow "full and fair" competition so that the existing telephone companies would be permitted to respond to the new entrants by adjusting their own prices. Since so much of the subsequent controversy surrounding competition in the telephone industry flowed from the *Specialized Carrier* decision, we should point out that the FCC, in that case, found it unnecessary "to speculate concerning the manner in which existing carriers may seek to respond to competitive conditions," but indicated that there "should not be any protective umbrella for the new entrants or artificial bolstering of operation that cannot succeed on their own merits."

What Does the FCC Mean by Competition? The question of what constitutes competition hardly arose in the case on interconnection and was avoided in the *Specialized Carrier* decision. But it could not be put off forever. The problem stems from the telephone companies' claim that, when faced with competition, they should be free to reduce their own prices in order to compete effectively. Their would-be competitors counter that if the telephone companies are totally free to set prices they will engage in predatory pricing to drive these competitors out of business.

There are two arguments here. One is that the telephone companies have an incentive to set prices below their "incremental costs" (the additional cost of providing a service) in order to thwart competition. The second is that the prices charged by the telephone companies should be sufficient to cover their "full costs" (incremental costs plus a share of overhead) on each of their services; otherwise, their behavior would represent unfair competition. For those who hold this view, even telephone company prices shown to cover incremental costs should not be permitted. Clearly, competitors who would be eliminated if incremental cost pricing were permitted might well survive if prices were set at full cost.

The FCC's views on these matters are now clear. Following the commission's decision to allow business firms to construct their own private-line systems, AT&T had introduced Telpak, a service offering lower prices for private-line service to customers who contracted for the use of multiple circuits. The objective was, of course, to discourage firms from developing their own systems. In the Telpak case (*In the Matter of American Telephone and Telegraph Company, Long Lines Department*, 1976), the

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commission rejected AT&T's contention that it should be permitted to respond to competitive pressure by reducing prices to (but not below) incremental cost. AT&T had argued that price reductions would enable it to retain the business it would otherwise lose to competitive suppliers even when its costs were lower than theirs, while also ensuring that other users would not be "burdened" by higher prices as a result of the competitive response. The FCC held, however, that AT&T's prices could not be set below "fully distributed cost" (another name for full costs). In other words, AT&T's prices for these services would have to include a "fair" share of the system's overhead costs.

Interestingly, one reason given for denying the use of the long-run incremental cost standard was that the commission would have difficulty monitoring its use. That is, the FCC believed it was not able to determine whether the long-run incremental costs claimed actually reflected the additional costs of providing service. But that determination is precisely what would be required to ensure that AT&T's prices on these services not be so low that other users would have to pay higher prices. The commission therefore adopted a policy that probably runs the risk of new carriers' entering markets where their costs are higher than AT&T's. Thus the *Wall Street Journal* was correct when it reported (September 24, 1976) that the decision would result in *more* competition and *higher* prices—correct, that is, if we recognize that "more competition" is being defined entirely by the number of firms.

Our second piece of evidence on the manner in which the commission is deciding the terms of engagement between existing firms and newcomers is found in a 1976 FCC report on the effects of competition in the terminal equipment and specialized carrier markets.[1] There, the FCC found "no convincing evidence" that AT&T's rates on terminal equipment and private lines covered full costs.

This conclusion is perfectly consistent with the commission's decision in the Telpak case. It does not require a belief that telephone carriers are providing services (either local or private-line) to business users at prices below incremental cost—only that their prices do not reflect incremental costs plus a share of overhead costs.

The commission began with a laudable goal—to open previously monopolistic markets to competition. But it failed to realize that eventually it would have to decide what competitive responses existing firms would be permitted to make. When the issue was finally faced, the commission held that telephone companies' prices are too low when they fail to cover some arbitrarily defined "full" cost. So, in the end, the FCC may have done what it said it would not do—establish an umbrella that protects the entrants it has encouraged.

. . . in the end, the FCC may have done what it said it would not do—establish an umbrella that protects the entrants it has encouraged.

Without for a moment underestimating the difficulty of regulating a monopoly faced with competition in some of its activities, the FCC can be criticized for not realizing that, once it opened the industry to new firms, it could no longer avoid this problem of determining the permitted competitive responses. It is a bit peculiar that, in the Telpak case, the FCC rejected incremental cost pricing partly because "standard accounting systems (including the ones used in the telecommunication industry) typically do not provide . . . data [on marginal costs]," when the commission could have had the companies provide that data.

One result of the commission's actions may be to reduce the benefits that can be obtained from competition. But might there not be an alternative that would overcome the commission's inability to regulate effectively and still preserve the benefits of competition? Since the problems troubling the commission arise because the same firm provides both competitive and monopoly services, one might consider separating the firm into its competitive and monopoly parts.[2] Of course, this alternative is attractive only if there are no cost advantages from combining the two services in one firm. Of the two areas in which competi-

[1] *Economic Implications and Interrelationships Arising from Policies and Practices Relating to Customer Interconnection, Jurisdictional Separations and Rate Structure*, 1976.

[2] The FCC has adopted this approach in regulating the provision by the telephone companies of certain data transmission services.

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tion has been permitted, such advantages appear less likely with interconnection than with private-line services. In fact, one of the objectives of a current antitrust suit brought by the Department of Justice against AT&T is to force the divestiture of the company's manufacturing arm, Western Electric. If there are no cost or other advantages from combining the provision of telephone service and telephone equipment—AT&T argues to the contrary—then divestiture would permit the commission to leave the equipment market unregulated. While we cannot now judge the desirability of this approach, it is one that deserves consideration.

Competitive Entry in Television

Here we examine FCC policy on pay-TV (where viewers pay directly for programs provided via cable or occasionally over the air), cable-TV (whose primary service is to retransmit programs from broadcast TV), and the allocation of the radio frequency spectrum to television.

Pay Television. American commercial television has, since its inception, been financed almost entirely through revenues obtained from advertisers. An early attempt to develop a pay-television system in California was thwarted by the passage of a referendum banning such systems in the state. The referendum, which had substantial backing from both theater owners and over-the-air broadcasters, was later declared unconstitutional.

In the late 1950s, the FCC proposed a large experiment to test the desirability of pay-television systems, but was soon forced to retreat from this ambitious undertaking. Instead, it permitted a far more modest experiment in a single city—on the basis of which it concluded that pay television, if restricted so that it did not threaten free television, would be a "beneficial supplement." The commission then promulgated a series of rules severely restricting the kinds of programming that could be offered by over-the-air pay television. The rules, which limited the movies and sports that could be carried and banned series programming entirely, were eventually extended to pay-television systems that used cable to transmit programming.

Despite these restrictions (and others), pay-television operations that "piggyback" on existing cable-television systems have experienced modest growth by exploiting a gap in the rules permitting new films to be shown. Recently, the FCC relaxed these rules to permit the carriage of movies up to three years old (*Subscription TV Program Rules*, 1975)—the previous limit had been two—and to permit series to be shown.

Not content with this outcome, one of the major firms in the industry, Home Box Office, asked the courts to overturn the entire set of programming restrictions on pay-cable TV. And, in *Home Box Office* v. *FCC* (1977), the Court of Appeals for the District of Columbia struck down all the rules—holding, in effect, that the FCC had failed to provide substantial evidence that the rules served the public interest: "Even if the Commission had jurisdiction to promulgate its . . . rules there is no evidence in the record supporting the need for regulation." The commission had argued that unless pay television was restricted in what it carried, it would "siphon" programs from advertiser-supported television and that this would reduce the quality of what viewers could receive over the air. But the court held that those who would impose regulation needed substantial evidence to support that imposition and that they had failed to present that evidence. Rather than simply accede to the commission's expertise in this matter, the court chose instead to examine the record for evidence of the benefits that would arise from the regulations and, having found none, sent the regulations back to the commission.

. . . there are at present no remaining regulatory barriers to pay television and . . . decisions on the future shape of the industry can be left to the marketplace.

The Supreme Court has refused to accept appeal of the lower court decision. Thus there are at present no remaining regulatory barriers to pay television and—unlike the situation in the cases of terminal equipment and specialized carriers—decisions on the future shape of the industry can be left to the marketplace. Any further restrictions will have to be obtained either through legislation or through

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an FCC policy for which the courts find "substantial evidence."

Cable Television. A superficial look at the regulation of cable television over the last decade or so might lead one to conclude that the barriers to the development of cable are being slowly but surely removed and regulation gradually reduced. The rules adopted in 1972 (*Cable Television Report and Order,* 1972) provide that cable systems in major markets may "import" distant signals where previously they could not, and the recent elimination of the "leapfrogging rules" (which limited importation to signals from the closest markets) has a similar effect (*Leapfrogging Rules–Cable Television,* 1976). Indeed, relying on the fact that the 1976 General Revision of the Copyright Law made cable systems liable for copyright payment when they retransmit programs originally provided by a TV broadcaster, the National Cable Television Association has asked the FCC to remove all remaining restrictions on what cable systems can carry. Combined with the elimination of restrictions on pay cable, these changes promise substantial growth for cable television. Unfortunately, however, the manner in which the copyright revision treats cable TV suggests that regulation of this industry may merely be shifting from the FCC to the newly created Copyright Royalty Tribunal.

The new law creates a compulsory licensing arrangement under which cable systems may carry all signals currently authorized by the FCC upon payment of fees into a fund to be distributed among program suppliers. Apart from the fact that the fee schedule seems low when compared with the prices that would have emerged from negotiations between cable systems and program suppliers, the provisions for changing the schedule in response to changes in FCC rules are quite troublesome. The new copyright act requires that the Copyright Royalty Tribunal revise fees whenever the FCC changes its cable rules and that the fees are to be "reasonable," but does not tell the tribunal how reasonableness is to be judged.

The imposition of full copyright liability —an alternative that could have eliminated the need for restrictions on signal importation and provided for adequate compensation to program suppliers—was rejected by the Congress. As a result, the level of the fee schedule is likely to provide the FCC with a convenient excuse for continuing some restrictions. But, even if the restrictions should be removed, the controversy would simply shift to the Copyright Royalty Tribunal, which would then have to consider changing the fee schedule.

. . . the adoption of a system of compulsory licensing virtually guarantees continuing regulation [of cable TV].

Here, clearly, is a missed opportunity. Whereas full copyright liability could have provided a basis for ending all restrictions on cable, the adoption of a system of compulsory licensing virtually guarantees continued regulation.

The VHF Drop-In Plan. In 1973, the Office of Telecommunications Policy (OTP), the agency then charged with formulating regulatory policy in communications for the executive branch, recommended that additional VHF television stations be "dropped into" (created in) portions of the frequency spectrum previously thought unusable because of potential interference with other stations. OTP argued that technological improvements since 1952 (when the FCC's television frequency allocation plan was adopted) had made these so-called drop-ins feasible. Since UHF stations find it difficult to compete with VHF stations, OTP's plan would have increased television competition, whether UHF stations switched to VHF or new VHF stations entered the market. These developments might even have contributed to the prospects for a fourth network.

The response of the television industry was predictable. It argued that many of the proposed stations would provide an unacceptably high possibility of electronic interference. The FCC, agreeing in part, rejected a large number of the proposed drop-ins on technical grounds. Of greater interest, however, is the commission's treatment of those drop-ins it judged to be technically feasible.

The industry had argued that, even if stations could be added without causing interference, the new stations would threaten the economic viability of existing stations, particularly those in the UHF band. (It is especially in-

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teresting that one of the groups arguing most vociferously for the protection of UHF stations is composed almost entirely of VHF stations.) Accepting this argument, the commission held that a new VHF station should be permitted in a market only if it demonstrably would neither force an existing UHF station off the air nor threaten the viability of a UHF station that might be likely to go on the air *in the next ten years* (*TV Broadcast Stations, Adding of New VHF Stations in the Top 100 Markets*, 1977). With this stringent requirement, only four drop-ins were proposed and the FCC is currently entertaining comments on their desirability.

The commission's action is not surprising. Having created and nurtured UHF television, it reacts in a predictable fashion against any threat to that system. The restrictions on cable and pay television demonstrate the FCC's solicitude for its children. However, there is an important difference between these restrictions and the FCC's treatment of the drop-in proposal. The restrictions are defended on the grounds that expansion of pay and cable television would reduce the amount of free over-the-air TV—to the detriment of viewers too poor to afford either. Moreover, the growth of cable might jeopardize the commission's long-standing policy of supporting local stations.

. . . the commission continues to protect UHF television without having substantial evidence that this benefits viewers.

But the VHF drop-ins pose none of these threats. They would operate over the air, would be advertiser-supported, and would be local stations. At worst, their introduction would merely displace one local station with another. Nonetheless, the commission continues to protect UHF television without having substantial evidence that this benefits viewers. (The only evidence that the commission examined was on the impact the drop-ins would have on the *number* of UHF stations.)

In this case, contrary to those involving Carter Electric, MCI, and Home Box Office, no firm has come forward to protest commission policy. The Department of Justice has filed objections, however, arguing that new VHF stations found to be technically feasible should be authorized "on demand."

Conclusion

The ideal candidate for deregulation is an industry that would otherwise have operated in a competitive manner but that, having fallen into the clutches of a regulatory agency, has fewer firms, charges higher prices, and offers a poorer array of products than could be expected under competition. The solution to the problem, in these cases, is simply for the government to "go away." This is essentially the solution proffered by advocates of deregulation of natural gas production, interstate trucking, and domestic airlines.

A more difficult case for the deregulator arises in industries where there are elements of natural monopoly and where even a neutral observer might argue that regulation of some kind could increase consumer welfare. Thus, we hear little talk about deregulating the local distribution of natural gas or electricity.

The most difficult case arises where competition seems feasible in part of an industry but where elements of monopoly seem unavoidable in other parts. One might "go away" and leave the industry and its consumers to their own devices, but if one wishes to regulate the monopolistic part of the industry, then leaving the putatively competitive part alone may not be the best alternative. A more complex deregulation strategy may be required in this case.

The communications industry contains examples of all three situations. Cable television and pay television offer opportunities for the government simply to go away. In pay TV, the opportunity is about to be seized, but in cable it is likely to be ignored. Local telephone service, a natural monopoly (because, with the technology used thus far, duplication of services is wasteful), is unlikely to be deregulated any time soon. However, there may be instances of improved regulation through basing more rates on marginal costs and tailoring prices so as to smooth out the peak and off-peak loads on the system. The most difficult cases for deregulation come in the long-distance telephone and terminal equipment markets, with their blends of monopoly and competition. Here, it may not be feasible for government regulation simply to disappear. In any event, it is unlikely that it will disappear soon. ■

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Deregulating Transportation

Tracking the Progress

Thomas Gale Moore

AT A 1971 CONFERENCE on promoting competition in regulated markets, Merton Peck of Yale University said he had attended a conference on the same theme ten years earlier and was looking forward to another one in another ten years. Apparently, what he did not expect in the interim was real progress toward deregulation.

Professor Peck was too pessimistic. Two measures to reform transportation regulation have been enacted in the last two years, a major reform for a relatively minor industry (air cargo) and a minor reform for a major industry (railroads). Moreover, the future looks good for additional deregulation. Congress, with the urging of the Carter administration is likely to relax airline regulation before too long. And, for the first time in modern history, there is now a chance to reduce regulation of trucking.

A Major Reform for a Minor Industry

In November 1977 the President signed a bill (H.R. 6010) making entry into the air cargo industry virtually free and giving operators wide discretion in setting rates. As of November 1978, any U.S. citizen will be able to submit an application to operate an all-cargo service, and the Civil Aeronautics Board (CAB) must issue a certificate within 180 days, unless the applicant is found not "fit, willing and able." This means that both aspiring and existing air cargo carriers (including passenger airlines that operate all-cargo services) will be able to initiate or extend their all-cargo operations anywhere within the forty-eight contiguous states and to use aircraft of any size. Furthermore, air freight operators (both all-cargo and combination freight) will be able to charge any rates, with certain exceptions, and the board loses its power to suspend challenged rates pending a hearing. Rates will still have to be filed with the CAB, however, and can be held unlawful if the CAB finds them to be unjustly discriminatory or predatory, or to represent undue preference or deceptive practices under existing regulations.

Why did this reform, certainly a larger step toward complete deregulation than is being contemplated for any other industry, sail through Congress so easily? For one reason, air cargo—which moved less than half of 1 percent of U.S. domestic freight in 1975—is only a minor (though fast-growing) industry. More important, all the firms that are principally engaged in the air freight business—Flying Tiger Line, Federal Express, Summit Airlines, Seaboard World, and Airlift International—supported the legislation, while the major air carriers, for whom air freight is a smallish item, were only mildly opposed. Furthermore, shippers as a group did not take a strong concerted stand, probably because most of them use air freight for special occasions and not as a bread-and-butter service. Thus, the American Retail Federation supported free entry but wanted the CAB to keep control over maximum rates;

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the National Industrial Traffic League agreed about rates but favored relaxed, not free, entry. Finally, organized labor, although generally hostile to deregulation for any sector of the air transport industry, was more concerned about scheduled passenger service than cargo.

. . . the suddenness of the deregulation of air cargo . . . is a hopeful sign, but not much more than that.

In short, the suddenness of the deregulation of air cargo, carried through despite some opposition by shipper groups, the Teamsters, and most of the large certificated carriers, is a hopeful sign, but not much more than that. It does show, I think, that economists have successfully demonstrated the public benefits of free markets in transportation—successfully enough to bring about change in the absence of strong countervailing power.

A Minor Reform for a Major Industry

The major reform of a minor industry was relatively easy, but the minor reform of a major industry—the railroads—was achieved only with great difficulty. After twenty years and more, the mountain labored and brought forth the Railroad Revitalization and Regulatory Reform Act of 1976, called the 4-R Act. This establishes a narrow "no suspend" zone of reasonableness [1] and encourages the use of seasonal and regional rates, but makes abandonment of lines even more difficult than before.

The 4-R Act provides new standards for just and reasonable rates: a rate cannot be considered unjustly or unreasonably low if it at least equals variable costs (costs that vary with the level of output produced); and a rate cannot be considered too high unless the carrier has "market dominance." In addition, carriers cannot be required to hold their rates at a particular level to protect the traffic of any other carrier (or mode of transport) unless the proposed lower rate is below variable cost. Finally, the act provided for a two-year experiment (the "Yo-Yo" provision) whereby railroads could raise or lower rates 7 percent from the level at the beginning of each year without fear of suspension—although the reasonableness of a change could be questioned and the new rate ultimately rejected, and although a rate could still be suspended if market dominance were found to exist. Very few "Yo-Yo" rates were filed (all of them increases), partly because the provision offered so little additional rate freedom.

The Interstate Commerce Commission has established three criteria for market dominance so strict that they seriously conflict with the rate flexibility intended by Congress and the administration. First, the railroad is presumed to have market dominance if it has a market share greater than or equal to 70 percent of the relevant market. (About 45 percent of current railroad traffic is, in the commission's view, likely to meet this market dominance test.) Second, the railroad is presumed to have market dominance, no matter how small its market share, if the rate equals or exceeds 160 percent of variable cost.[2] (About 11 percent of current traffic moves at rates estimated by the ICC to be equal to or more than 160 percent of variable costs.) Third, market dominance exists if shippers or consignees have an investment in rail-related equipment or facilities large enough to prevent or make impractical the use of another carrier or mode of transport. (About one-quarter of rail traffic would meet this test.)

Altogether the commission estimated that some 48.5 percent of railroad traffic would meet one or more of these tests. Of the nonmarket-dominant traffic, some 57 percent is carried at rates calculated by the ICC to be below variable cost and therefore noncompensatory. Since railroads are free to raise these rates to variable costs, the fact that they fail to do so implies that the rates cover marginal costs and that competitive conditions are such that rates cannot profitably be increased.

[1] A "zone of reasonableness" is a range, normally a certain percentage above and below prevailing rates, within which carriers may raise or lower rates. The concept is usually coupled with the limitation that rate changes within the zone, while they may not be suspended forthwith, may be investigated and ultimately declared unlawful (and presumably any excess revenues refunded).

[2] If either the first or the second condition is met, there is said to be a "rebuttable presumption" that the carrier has market dominance, meaning that the carrier may contest the point but that the burden of proving that it does not have market dominance is on the carrier.

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Generally, the ICC's market dominance test has kept the railroads from seeking higher rates where shippers would pay them and has authorized the railroads to charge higher rates where market conditions will not permit them. Hence, it has not led to rate flexibility. In fact the only real improvement in regulation as a result of the 4-R Act has been some encouragement of seasonal rates: three such rates have been filed.

While the 4-R Act is too new to be adequately judged, it is clear that its interpretation by the ICC . . . is frustrating the intent of Congress.

While the 4-R Act is too new to be adequately judged, it is clear that its interpretation by the ICC, especially the definition of market dominance, is frustrating the intent of Congress. Moreover, so far, the railroads' use of the act to go after new traffic has been meager.

There are at least two lessons to be learned from the 4-R Act. First, the railroads are clearly reluctant to cut rates to attract business from their competitors. The reasons may be that price cuts would draw too little traffic to be profitable, that lower rates would be below marginal costs, or that railroad executives are not sufficiently market-oriented to exploit the existing opportunities. Probably all factors are at work. Second, Congress is timid about permitting free pricing, and the ICC, like most other regulatory agencies, will continue to stifle competition. In other words, significant regulatory reform is difficult to achieve.

If reform of airline or trucking regulation is to be significant, it must go beyond what the Congress did for railroads and must be structured so that an unfriendly regulatory commission cannot frustrate its purposes.

Airline Deregulation

The air cargo bill was spun off from the airline deregulation bill when it became apparent that the latter would not be passed in 1977. But air passenger service is nonetheless the next candidate for deregulation.

Education of Policy-Makers. During the Great Depression of the 1930s, many economists and policy-makers lost faith in the ability of the market to handle economic affairs. In the transportation area, this contributed to the passage of the 1935 Motor Carrier Act and the 1938 Civil Aeronautics Act.

Opinion changed slowly. Even through the 1950s, economists and policy-makers who were concerned with regulation were primarily interested in making it work better, not in scrapping it. Not until 1962, when Richard Caves published *Air Transport and Its Regulators*, did the tenor of academic thinking begin to change. Caves concluded that "the air-transport industry has characteristics of market structure which would bring market performance of reasonable quality without any economic regulation. . . ." His was the first major empirical and theoretical work to come down clearly for airline deregulation.

Michael Levine, in his 1965 article on air transportation within California, first pointed out that an unregulated intrastate carrier performs better than a CAB-certificated airline. Five years later, William A. Jordan's *Airline Regulation in America: Effects and Imperfections* brought to a wider audience the evidence on the difference between a CAB-regulated airline industry and airlines operating in a largely unregulated environment. To this day the strongest evidence in favor of airline deregulation is the performance of unregulated intrastate carriers in California and Texas.

The annual reports of the Council of Economic Advisers give one indication of what economists and policy-makers were thinking about regulation in the post-war period. The first mention of transportation regulation appeared in the 1965 *Annual Report* and amounted to two paragraphs; the ICC was mentioned once and the CAB not at all. The next year's report contained a much stronger several-page section on surface transportation. The first mention of CAB regulation, one paragraph long, came in the 1970 report and the first extensive treatment in 1971.

Congress has lagged behind the executive branch in accepting the idea of deregulation. In 1975, the Senate Subcommittee on Administrative Practice and Procedure, chaired by Senator Edward Kennedy (Democrat, Massachusetts), held extensive hearings on airline

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regulation and issued a major report indicting the system. In spring 1977, the Senate Subcommittee on Aviation covered the same ground in additional hearings. Yet, in September 1977, Senator Daniel Inouye (Democrat, Hawaii) told a meeting of that subcommittee that the arguments for automatic entry were "pure nonsense" and that there was no evidence that deregulation would produce lower fares. As for the House of Representatives, several bills, including one proposed by the Ford administration, were introduced in 1975–77 and the House Subcommittee on Aviation held hearings in 1976 and 1977.

For those who have become discouraged with the pace of airline deregulation, the preceding narrative should give some perspective. The economics profession itself was not convinced of the merits of deregulation until the 1960s. A fair summary might be that economists were educating themselves on the subject throughout the 1960s and that general agreement began to emerge only after the appearance of Jordan's book in 1970. The last eight years have been spent convincing the media, the Congress, and government officials.

Current Proposals. In late 1977—after twenty-two markup sessions that can be generally characterized as exercises in education—the Senate Committee on Commerce, Science, and Transportation approved (11–2) the Kennedy-Cannon bill. According to *Congressional Quarterly,* much of the delay was caused by committee members' unfamiliarity with the regulation issue. The airline bill being considered in the House, one sponsored by Representative Glenn Anderson (Democrat, California), is much like Kennedy-Cannon. The Committee on Public Works and Transportation plans to act on this bill in 1978.

The Kennedy-Cannon bill, as voted out of committee, would provide reform in two essential areas, rates and entry (including route flexibility):

- Airlines would be allowed to raise fares as much as 5 percent or lower them as much as 35 percent without CAB approval.
- Any existing airline would be allowed automatically to enter one new route of not more than 3,000 miles in each of the first two years after enactment; in the third year, each airline could enter two new routes a year, not exceeding 3,000 miles total, without CAB approval. Moreover, each airline could designate three routes that would be protected from automatic entry by other airlines during the first three years, two routes in the fourth year, and one in the fifth; after five years no route could be protected, but the Civil Aeronautics Board would have the option of making a change if the program had created hardships for some airlines or communities.
- Airlines could drop routes, but only after ninety days' notice. "Essential" services to small communities could be subsidized by the CAB.
- A new firm desiring to become a certificated carrier would need only show that its proposed service was "consistent with," not that it is "required by," public convenience and necessity. Although the committee decided, after a long battle, that the burden of proving such consistency would remain on the applicant, the language change is designed to diminish that burden. How significant the change would prove to be, in and of itself, cannot be predicted. The bill would also eliminate the principal hurdle to establishing public convenience and necessity—the fact that this phrase has long been interpreted as protecting existing carriers against competition that would substantially injure them. The bill states that more innovative or efficient methods of operation or significant price reductions are consistent with public convenience and necessity and that the possibility a potential new competitor will divert revenue from an existing carrier is not necessarily inconsistent with the public convenience and necessity.

Prospects. The academic community has done the research on airline deregulation. The prospects for reform now lie in how successful various groups—including the academy—will be in influencing the Congress. The major proponents of at least partial deregulation are the Carter White House, the Council on Wage and Price Stability, the Council of Economic Advisers, the Antitrust Division of the Department of Justice, a somewhat reluctant secretary of transportation, and some voices from the Civil Aeronautics Board—in particular, its chairman and some staff. In addition, a group entitled the Ad Hoc Committee on Airline Regulatory Reform—which includes a highly

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unlikely assortment of organizations representing conservative Republicans, liberal Democrats, Naderites, retailers, retired persons, students, and business interests—is strongly supporting the effort. United Airlines, Pan American Airlines, Frontier Airlines, Hughes Air West, and Pacific Southwest Airlines also favor change.

The provisions in the Senate bill for protecting small towns appear to be adequate to assuage the worries of most small communities that they would lose service under deregulation. On this subject testimony before the Senate last spring tended to be muted.

Opposing deregulation are the other major airlines—which claim that United is on the other side because it has the largest network and so is in a good position to gain from the proposed route flexibility. Organized labor is also strongly opposed. No doubt labor understands that deregulation would be more likely to lead to airline expansion with increased passenger traffic than to a significant reduction in airline jobs. What organized labor really fears is that the growth of non-union airlines would spread if entry into the airline business were reasonably easy, and that this would put downward pressure on the pay scales and employment opportunities for unionized flight crews and support personnel. Furthermore, the labor protective provisions added to the Kennedy-Cannon bill are designed only to ease the transition for unemployed airline workers, and not to maintain union wages well above non-union wages. Airline labor therefore will lobby hard to bottle up any bill.

Banks and insurance companies are also resisting the bill. According to William McCurdy, former vice president of Equitable Life Assurance Society, "it is the consensus of the financial community that a period of substantial upheaval, if not chaos, will result . . . while present company positions change."

In recent months, as support for deregulation has been gathering momentum, the airlines have been engaging in some price competition in an attempt to convince the public that reform is not necessary. This, along with the liberalization of charter rules, explains the rapid expansion of discount fares that has occurred. But at the same time, CAB decisions to deny some rate cuts in order to protect the charter carriers point up the problem of continued regulation, even under a chairman who favors competition.

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Nevertheless, for the first time since airlines were regulated in 1938, it now seems likely that a partial deregulation bill will be enacted. The only question would seem to be timing. My guess is that it will occur within three or four years, maybe even this year. Once this happens, no further deregulation can be expected in the airline industry for at least another decade. Before going further, the Congress and public officials will want to see how this bill works. That will depend in part on how the CAB interprets its provisions. Will the board, for example, be liberal in approving applications for operating certificates of public convenience and necessity, or will it construe the words "consistent with" very strictly? In the meantime, the focus of regulatory reform will shift to the trucking industry.

Motor Carriers

The prospects for significant deregulation of the trucking industry are not nearly so bright as the prospects for airline deregulation. No bill is currently before Congress. The secretary of transportation is opposed to any change in the statute. And the White House, though it generally favors the concept, has not yet indicated what its position will be.[3]

Education of Policy-Makers. Virtually from the date the Motor Carrier Act was passed, economists have criticized the idea of regulating such an inherently competitive industry. In the ensuing four decades, the effects of regulation on trucking rates, costs, efficiency, and service quality have been subjected to consid-

[3] According to press reports, President Carter is considering three options: legislation mandating significant deregulation of the airline industry variety, reforms undertaken by the ICC backed up by a congressional resolution to encourage action, and ICC reforms only.

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erable analysis. It has been shown, for example, that the trucking of commodities exempt from ICC control works well, with many firms having operated in that segment of the industry for years. It has also been shown that rates in regulated trucking are considerably inflated. Various estimates have been made of the costs of regulation and of the benefits to special interest groups that regulation produces. The unregulated British and Australian trucking systems have been described. The subjects of service to small communities and of less-than-truckload shipments have been well analyzed. Yet Congress remains unimpressed.

In 1955 Secretary of Commerce Sinclair Weeks chaired a cabinet committee that drew up a mixed bag of recommendations on transportation policy. On the one hand, it proposed tighter ICC control over exempt agricultural trucking and private trucking—a proposal that would be hard to imagine today. On the other hand, it proposed a zone of reasonableness for railroad rates—with minimum rates equal to variable costs, maximum rates at least equal to full costs, and rates for traffic with no substantial competition held to a "reasonable" limit. The zone-of-reasonableness concept has appeared in various regulatory reform proposals in recent years and, as noted, was timidly introduced in 1976 in the 4-R Act.

In 1962 President Kennedy proposed a bill providing for some significant deregulation of railroads, trucks, and barges. A similar bill was introduced in 1963 and further hearings were held. The next year the House Committee on Interstate and Foreign Commerce put together a bill that included complete deregulation of agricultural carriage by all modes of transport. The Johnson administration, believing it had to oppose that great a degree of deregulation, allowed the bill to die.

In the mid-1960s a presidential task force on transportation policy recommended, among other things, the removal of legal barriers to entry and route abandonment on the part of common carriers (rail, truck, and airline), the elimination of most of the ICC's authority over minimum rates, repeal of the long-haul/short-haul provisions of the Interstate Commerce Act, amendment of that act to deny carriers the right to request suspension of proposed rates, and amendment of the Federal Aviation Act to eliminate rate regulation of all unsubsidized domestic air-passenger transport. No legislation resulted, but the task force's report was widely circulated in the government.

The next major attempt to amend the Interstate Commerce Act occurred in 1971 when the Department of Transportation proposed the Transportation Regulatory Modernization Act (which the White House had decided not to sponsor because of Teamster opposition). This proposal would have reduced control over entry into trucking, facilitated the broadening of existing certificates both as to the commodities that could be carried and the routes that were authorized, and established a zone of reasonableness for rates. (The zone specified ranged from a floor at variable cost to a ceiling at 150 percent of fully allocated cost. Any proposed rate within this zone would have been, per se, legal unless it violated the long-haul/short-haul clause or was unjust, preferential, prejudicial, or unduly discriminatory.)

Both the Senate and the House held extensive hearings on this bill in the spring of 1972, but no bill was passed. The bankruptcy of the Penn Central in 1972 and the ensuing effort to reorganize the northeast rail network both helped and hurt the deregulation effort. While these events focused attention on transportation, especially rail, and made some congressional response imperative, they also diverted attention from the costs of trucking regulation. Moreover, although regulation played a part in the sorry financial position of the railroads, there were more immediate reasons for the Penn Central's collapse. The most that could be expected by even the most optimistic deregulators was that over time some deregulation would help the railroads, while possibly making them worse off in the short run. What was needed was a "quick fix" and not a fundamental change in the rules. The eventual passage of the 4-R Act can, however, be attributed to the Penn Central debacle and to the earlier studies on the advantages of decreased regulation. Indeed, the act's deregulation provisions were made a condition of Ford administration support of the financing provisions.

The Prospects for Motor Carrier Reform. As mentioned before, the prospects for even partial deregulation of trucking are not great. The subject is not of paramount interest to voters; and consumer groups, though they favor de-

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regulation in principle, are not likely to give it their best efforts.

Strong approval can, however, be expected from the academic community, the Antitrust Division of the Justice Department, the Council on Wage and Price Stability, the Council of Economic Advisers, and key members of the White House staff. In addition, Senator Kennedy, who was so instrumental in stimulating congressional interest in airline reform, is planning to do the same thing for trucking. His antitrust subcommittee held hearings in October 1977 on legalized rate agreements and rate fixing by motor carriers, and the hearings scheduled for this year will cover all aspects of motor carrier regulation.

Some support for deregulation may, it is true, arise within the trucking industry itself. The editor and publisher of *Overdrive*, a magazine for independent truckers, has advocated deregulation and there are certificated carriers, both large and small, that could benefit from reducing entry restrictions. But outside of government and the academy, it is still hard to find much support for the idea. Among shippers, some are for free entry into the industry, while many others—concerned about low rates for their competitors or higher rates for themselves—are fearful of changing the system. Thus, while the users of airlines (the passengers) favor a freer market in that industry, users of trucking services do not unanimously or even overwhelmingly support it in theirs. Moreover, small communities worry that freer exit from the market would mean that they would lose the services they now receive. Guarantees may have to be included in any proposal in order to mitigate their opposition.

. . . outside of government and the academy, it is still hard to find much support for [trucking deregulation].

But it is the owners of operating rights (who fear for the value of their assets), along with the labor unions and the railroads, that are most strongly opposed. A provision for buying out the owners' operating rights, proposed recently in a *New York Times* editorial, might help move a major deregulation bill through Congress—even though many would be opposed to such a use of taxpayer money, especially since large numbers of these owners are quite wealthy. In any case, paying off the owners would not eliminate the vehement opposition of organized labor. The Teamsters fear, with justification, that free entry would open the industry to a flood of non-union trucking firms. Certainly, owner-operators would be a major threat to the high wages Teamsters currently receive. Finally, determined resistance can be expected from the railroad industry, because deregulation would produce lower freight rates for motor carriers, enabling them to capture traffic from the railroads. While railroad managements could and would respond with lower rates, they do not believe that lower rates—let alone the loss of business to trucks—would be in their interest.

Supporters of regulatory reform have not yet faced this last issue. The fact is that deregulation of trucking would probably make the already sick railroad industry sicker in the short term, even if it resulted in the elimination of railroad regulation so that the railroads would be able to compete. Thus trucking deregulation could lead to significant pressures to subsidize or nationalize our rail system. Whereas total deregulation of all surface transport should eventually produce a healthier and slimmer railroad industry, the transition could be so painful that Congress may not take the first step.

Unlike the CAB, the Interstate Commerce Commission is opposed to any tampering with its authority and is attempting to demonstrate that the goals of deregulation can be achieved without deregulation itself. Thus the commission has enlarged the unregulated commercial zones around big cities—to the chagrin of many in the trucking industry. In addition, the commission has been holding hearings on proposals to liberalize entry restrictions, finding, of course, that there are industry spokesmen on both sides of the issue. Moreover, the ICC is looking into the question of rate bureaus. The threat of congressional action has, at least, led to ICC activity.

If Congress deregulates trucking, it will be a testimony that academic scholarship and academic perserverance have convinced the public, the Congress, and government officials (who have, individually, not very much to gain) of the rightness of the cause. But if regulation of trucking is—as some recent studies

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seem to suggest—a process through which important groups receive benefits, there is little hope that Congress will act. The individual gainers would be unlikely to gain significantly, while the losers would suffer large losses.

Perhaps there would be a chance, though, even in this case, if consumer groups, Common Cause, the media, and a combination of liberals and free market conservatives could be induced to work for deregulation. At this time, two influential senators, Edward Kennedy and Charles Percy (Republican, Illinois) are actively in favor of change. With White House support, deregulation of trucking is possible in the next three to five years.

Conclusion

The best chance for regulatory reform now lies in the airline industry, where the case for change has been clearly made and its proponents are in a strong political position.

If airline reform fails in Congress, there is no hope for deregulating any other sector. But even if airline reform does occur, achieving trucking deregulation will be difficult. Yet, the probability is not zero and the industry is clearly worried. If motor carriers are deregulated, it will be important to turn again to the railroad industry and make a bold move to reduce ICC controls there. With trucking even partially free, railroad managements would probably support deregulation of their operations, leaving only shippers and labor opposed.

To end on an optimistic note, economists have shown that their profession can be influential. Without the studies and testimony of scholars, there would have been no movement towards deregulation. While economists can become discouraged with the pace at which Congress adopts their obviously brilliant analyses, given the opposition and given that economists generally "haven't met a payroll or run a railroad," it is amazing that they have had so much influence. ■

Lawyering and Democratic Capitalism
(*Continued from page 22*)

mission, whose new chairman promises "innovative" litigation, would take the hint.

Plainly, both adding judges and limiting discovery procedures will reduce judicial bottlenecks and permit even more questions to be brought to court. Is that really desirable? Perhaps it is only as the legal process becomes clogged and, therefore, judicial decision-making less available that private and political institutions will regain their own decision-making capacity. Of course, that suggests a form of rationing, which is always an extreme remedy—and particularly so here, since we cannot be sanguine that the courts or Congress would adopt the proper methodology to order the queue. It might well be those matters least appropriate for judicial resolution that gain the highest priority. (Note that the Speedy Trial Act of 1974, one attempt to order the queue by giving criminal cases a first priority, has had perverse consequences because of unrealistic time limits.) In any event, those at the bottom of the queue will surely protest their placement vigorously, claiming discrimination. Even now, Supreme Court efforts to limit class-action relief have been attacked as anti-poor, anti-consumer, and so on. However, to those who would so protest, I offer the thought that they might be benefitted in the long run, since they might gain greater effectiveness in the political process and that might be infinitely more valuable than reliance on adjudicators.

Still, we face a dilemma. Unless our political institutions mount a virtual counterrevolution against the legal process, our only hope of preserving the vigor of democratic capitalism may be for the legal process to become so unwieldy that private and political decision-making gain a comparative advantage. But then the legal process would be less available for those matters for which it is truly needed.

Is it too much to ask of American lawyers that they accept major responsibility for finding ways out of this dilemma? I do not think so. After all, American democracy was founded and set on its course by lawyers—albeit lawyers who were simultaneously farmers, businessmen, architects, and philosophers. Chief Justice Burger has repeatedly, but virtually alone, warned of the dangers of an over litigious society but he is, of course, constrained in what he can say; he cannot criticize specific legislative proposals or, except in his opinions, judicial imperialism. He deserves more support from an American bar that eschews self-interest (as far as that is possible) and concerns itself with the harmful impact of an ever expanding legal process on our society. ■

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Readings
of particular interest

Regulatory Agency Structure—Cause for Optimism?

Governance of Federal Regulatory Agencies by David M. Welborn (Knoxville, Tenn.: University of Tennessee Press, 1977).

This study, undertaken in response to growing public concern about the performance of regulatory agencies, examines the inner workings of the Civil Aeronautics Board, the Federal Communications Commission, the Federal Maritime Commission, the Federal Power Commission, the Federal Trade Commission, the Interstate Commerce Commission, and the Securities and Exchange Commission—known as the "Big Seven."

According to David M. Welborn, political scientist at the University of Tennessee, not enough is known about how a regulatory commission (as distinct from an agency headed by a single official) functions, and this may explain some of the recent criticism of the performance of these commissions and the attendant proposals for reform. Nonetheless, Professor Welborn emphasizes that his intention is not so much to evaluate these criticisms and proposals as "to explore the relationship between agency governance and those characteristics of performance identified as problems." Specifically, the lines of inquiry of this study are drawn in terms of the finding of the 1971 President's Advisory Council on Government Organization, headed by Roy Ash: that regulatory commissions are ineffective because of their independence of the President and their collegial character.

Professor Welborn's conclusion, based principally on interviews with present and former regulators, is that "systems of governance have developed [within the so-called Big Seven] so that the commission form is not a barrier to achieving performance aims, such as those put forth by the Ash council, or to achieving the diverse objectives sought in economic regulation." This conclusion rests on the determination that the commission chairman, partly because of legislation and executive orders in the 1950s and 1960s, has become the key to an agency's operations. The chairmen "stand apart from other regulators in scope of activity, engagement in regulatory processes, and in imprint on regulatory determinations." They have wide discretionary powers over such disparate matters as staff appointments and what issues are brought before the commission for collective consideration. Furthermore, they have a much larger public role than their colleagues since it is they who speak in behalf of their agencies before Congress and other organizations. The extensive role of the chairman in agency governance is, in sum, "secure in its underpinnings, stable in at least broad outline, and typically free of substantial, overt conflict."

Thus, in contrast to the Ash council's assertion that regulatory commissions suffer from "splintered management," the author describes their structure as consisting of "a fairly high level of integration around the chairmanship." In other words, suggestions that regulatory commissions need a single dominant executive instead of a collegial executive miss the point, since this is already what they have to a large extent. Moreover, just as the term collegiality no longer describes relations among fellow commissioners, the term independence no longer accurately describes relations between the regulatory commissions and executive branch agencies and departments. Indeed, according to the author, chairmen who accept appointments today often see themselves as part of the President's administration. In effect, these developments, along with the constraints embodied in the appointment process, the congressional appropriations process, and existing statutes and precedents, make it clear that regulatory commissions are not so

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independent as to be politically unaccountable.

Having suggested that the Big Seven as constituted can do what they are supposed to do—albeit, at times, with much difficulty because of the enormously complex task of trying to reconcile competing economic interests—Welborn presents suggestions for improving regulatory performance. Consistent with his theme of the expanded role of commission chairmen, he emphasizes ways to make fuller use of this position without diminishing "the working concept of collegiality." First, the President should try to appoint as chairmen individuals who can deal with both broad substantive issues and the myriad details of day-to-day regulatory business. Second, chairmen should use the skills and abilities of their fellow commissioners more effectively. Third, "innovative ways" for handling the multiplicity of regulatory tasks must be found. Finally, means for facilitating systematic coordination between regulatory agencies and other governmental bodies and organizations are needed.

The Burger Court and Mr. Bakke

"The High Court's Road in the Bakke Case" by A. E. Dick Howard, in *The American Oxonian*, October 1977, pp. 225-234.

In this review of *Regents of the University of California* v. *Bakke*, A. E. Dick Howard of the University of Virginia Law School traces the evolution of the Supreme Court's views on race since 1896, analyzes the arguments on both sides of the case, and gauges the likely responses of the Burger Court. Allan Bakke, a disappointed white applicant, is challenging the constitutionality of a special admissions program of the medical school at Davis, under which sixteen out of one-hundred places in the entering class are set aside for minority students.

According to Professor Howard, if the Court should choose to decide the case on the grounds of constitutionality, then "the central issue becomes one of deciding whether the 14th Amendment's guarantee of 'equal protection of the laws' permits a person's skin color alone to influence or determine his admission to a professional school."

The author finds it difficult to accept arguments that the Fourteenth Amendment does apply to "benign" race-specific acts, for these acts are certainly not benign toward those who are displaced and may also have the deleterious effect of undermining the self-respect of minority students. Moreover, the notion of race preference raises perplexing questions: "How many places in an entering class may be earmarked for members of a given race?" If race is simply one factor among many, how is it to be weighted? May all minorities be given preference, including those like the Asian-Americans who are already generously represented in regular admissions? At any rate, the author argues, to provide racial preference is to "risk exacerbation of racial resentment."

The Court's approach to racial issues has shifted, Howard notes, from the view that the Constitution is colorblind (stated in Justice Harlan's famous dissent of 1896) to support for racially based remedies to past injustices. Yet, according to Howard, the recent precedents justifying preferential treatment of minority applications as a means of remedying previous discrimination may not be applicable in the Bakke case, because there is no evidence that Davis has ever discriminated. Moreover, in cases where the Court has allowed the use of racial considerations, the situation has not been one of scarcity (a limited number of places), and the remedy has merely required shifting students or voters from one place to another, not denying some a place altogether.

The author does not expect the Court to disregard entirely its rule of "strict scrutiny" of racial considerations simply because those considerations are now being used to favor minorities instead of to discriminate against them. Nor does he expect the Court to "endorse the notion that minorities are entitled to something like a proportionate share of the country's doctors and lawyers" simply because their numbers are so low in these professions.

Indeed, the justices may wish to reject in principle the notion of race as a criterion for admission; but if they do they will be likely, in Howard's view, to consider the social impact of their decision. He suggests three ways for the Court to resolve the dilemma. (1) It could decide to substitute the concept of "disadvantage" for the concept of race. Though this remedy might end up helping mostly poor

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whites, this result cannot be predicted because few, if any, law or medical schools have tried out this approach. (2) The Court could decide to leave admissions policy to the universities themselves, just as it has kept its hands off other social issues it considers better left to local experimentation or to the political process. Finally, (3) the Court could outlaw "quotas" (Howard recognizes the difficulty of defining this word) but let the universities "use race as one factor in admissions."

Although Professor Howard believes the Court could easily duck the constitutional issue, the problem would remain. Thus he concludes: "As with the Brown ruling in 1954, there is a special need for a decision that is seen to rest on principle."

A Counterproposal for Containing Health Care Costs

"Health Care Cost-Containment Regulation: Prospects and an Alternative" by Clark C. Havighurst, in *American Journal of Law and Medicine*, Fall 1977, pp. 309-322.

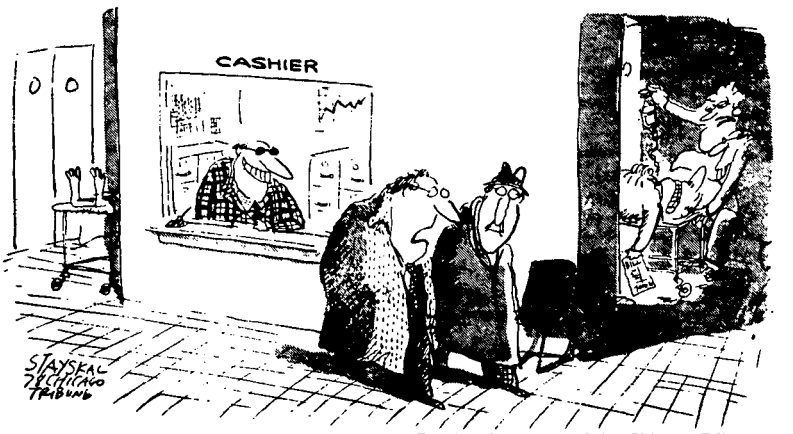
Clark C. Havighurst of the Duke University School of Law argues that regulation of health care for the purpose of containing overall costs is, in fact, a form of rationing. It is also, he says, a particularly difficult form of rationing for political institutions to undertake, because the public expects a high standard of health care and because that care has a symbolic value—health care is a "right"—as well as an economic value.

Necessarily, according to the author, cost-containment regulation would prevent patients from receiving, and professionals from providing, the care that both believe would be beneficial. The regulators "have been asked to say 'no' " in circumstances where everyone immediately concerned "is inclined —because they do not face the costs—to say 'yes.' "

Professor Havighurst argues that regulation sometimes seems advantageous because it is compared not with alternative policies but with doing nothing at all. Because the providers of health care have failed at self-regulation in their professional standards review organizations and will not perform the rationing function, there is a movement toward arbitrary forms of regulation or, in the author's words, "escalating arbitrariness." The proposal to establish a cap on health care costs and then allocate the permitted costs by political processes would deprive some consumers of care they wanted and give others care they would not purchase if they could. The natural tendency of regulation in health care is "toward narrowing consumers' range of choice, enforcing a false consensus, and obscuring the wide variations that exist in both consumer preferences and medical practice."

Havighurst suggests a market alternative. He would (1) reduce "excessive subsidization" of health insurance by changing the federal tax treatment of health insurance premiums, (2) encourage active competition between and among insurers, health maintenance organizations, and "new models of health care financing and delivery," (3) enforce antitrust laws in the health care professions to encourage experiments in cutting costs to consumers, (4) allow Medicaid and Medicare beneficiaries some choice between more health care and cash by giving them vouchers—or refundable tax credits—to cover their payments under those programs. In other words, he argues for a competitive market in the provision of health care, one that is free of government-instituted

'Boy, hospital costs are really getting out of hand. They charged me $385 and I only visited a friend in Room 212!'



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rigidities. In that kind of market it would be the patients and the providers, not the government cap, that would contain costs.

Folklore and the FDA

"Regulating Pharmaceutical Innovation: An Economist's View" by J. E. S. Parker, in *Food Drug Cosmetic Law Journal*, April 1977, pp. 160-181.

The author, an English economist now senior lecturer at Otago University in New Zealand, here compares the regulation of new drugs in the United States and the United Kingdom, taking into account the (1) folklore of a regulatory agency's operations, (2) the agency's terms of reference, administrative structure, access to scientific knowledge, methods of communication, procedures, incentive structure and attitudes toward risk, and (3) the basic underlying model of innovation.

He notes that American folklore counsels that delaying the introduction of new drugs is a benefit, while in Great Britain the folklore counsels that new drugs are good and "the regulatory agency is not considered fair game for parliamentary comment." Moreover, in the United States, drugs must be proved effective before they are used, while in Great Britain (at least by law) they need only be proved safe.

In the United States, the regulatory agency in question—the Food and Drug Administration—is a part of the executive branch (in British terms, "a full-blown department of State"), whereas its British counterpart—the Committee on Safety of Medicine—was, until 1968, quasi-independent and quite small. But now the CSM is an agency of the government and is, moreover, requiring retrospective review of drugs already introduced for effectiveness as well as safety. Nevertheless, even now, the British have not quite reached the U.S. situation where "the patient is protected from drug hazard and not from disease."

A further contrast is the fact that the FDA relies on in-house personnel, the CSM on outside experts—the latter being more likely to be acquainted with the frontiers of medical knowledge and, therefore, more likely to understand the nature of new drugs. Tied to this is the formality of procedure: the FDA needs all things in writing, while the CSM encourages person-to-person contact. On the question of risk, the U.S. system embodies a concern with "absolute risk," the U.K. system with "relative risk," in Parker's terms. U.S. drugs are to be "risk free," while in Great Britain the risk of using a new drug is to be measured against the risk of not using it.

Finally, the implied model of innovation in the U.S. scheme of things is one in which advances are made in predictable little steps, "where a compound is identified as having possible therapeutic value for a specific disease, and a highly directed routine is then followed from testing in animals through to evaluation in man." The British model implies a more sophisticated innovation process than the FDA's "disease specific potential drug" model —a process in which there may be more complicated and indirect paths to innovation.

With all this set out, Mr. Parker turns to the observed decline in new drug introductions in the United States, the decreasing productivity of R & D expenditures in the United States, the concentration of innovational output in the United States in larger established companies, the contrary trends in Great Britain, and the—so far, modest—export of U.S. resources to avoid FDA regulation. He suggests that, to reverse these trends, a new model of innovation is needed, a new attitude toward risk, new procedures, new use of outside experts, and—underlying all of this—a new folklore and political environment for the regulation of pharmaceutical innovation in the United States.

Weidenbaum on Government and Business

Business, Government, and the Public by Murray L. Weidenbaum (Englewood Cliffs, N.J.: Prentice-Hall, 1977), 336 pp.

Murray L. Weidenbaum, director of the Center for the Study of American Business at Washington University (St. Louis), designed this book for "future generations of business executives" as well as "government officials and members of various interest groups." Though the benefits of regulation are noted, and though all seven case studies come from gov-

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ernment sources, Professor Weidenbaum emphasizes the costs of regulation—to business and, through business, to the public. The book describes "far-ranging regulatory activities, which impinge on almost every business executive . . . in industries that are not ostensibly 'regulated' as well as those that are."

Part I on "Regulation by Government" deliberately adopts "at times an unconventionally critical view of federal intervention," designed to provoke discussion. The author considers consumer safety, automobile safety, job safety, environmental controls, and job discrimination, before turning to regulation via government procurement and government as financier. The chapter on procurement points out that the question of social responsibility has largely been settled for companies doing business with the federal government: they do what the government wants or they do not get government contracts. Many of these government-oriented corporations have taken on the characteristics of government bureaus, and the consequent loss of the "advantages of innovation, risk-bearing, and efficiency" is a high possible cost to the society as a whole. The chapter on the government as financier argues that government-guaranteed credit reduces the "amount of credit that can be provided to unprotected borrowers, mainly consumers, state and local governments, and private business firms."

Part II on "The Adaptation by Business" discusses passive, anticipatory, and active business responses to government controls. It appears to Weidenbaum that large firms are able to respond more actively and positively than small firms, though trade associations may help small firms in their response.

Part III on "Shaping the Business Environment" begins by examining the means by which business adjusts to increasing government involvement in its day-to-day activities—lobbying, trade associations (including their lobbying), and participation in the political process (the data suggest that some businessmen do not fully understand that process). Then, as a kind of capstone to the entire volume, Professor Weidenbaum examines the rising government presence in business management. This rising presence, he suggests, represents a "second managerial revolution." Just as the first managerial revolution transferred the locus of business decision-making from the firm's owners to the firm's managers, the second is transferring it from the firm's managers to the "vast cadre of government regulators."

As a case in point, the author focuses upon the proposal of the Initiative Committee for National Economic Planning to create a formal system of national economic planning, whereby the government would forecast demand for goods and "induce" industries to meet the demand forecast (the means of "inducing" being laws, as specific as necessary). Proposals for federal chartering of corporations and a requirement for public members (including labor representatives) on boards of directors, if enacted, would also help bring about a basic change in the nature of corporations and in the relationship between business and government.

The present relationship, in Professor Weidenbaum's words, appears to be "basically adversary in nature." Rather than continuing along this line or embracing a government-business partnership on the European or Japanese model (which would submerge the public interest, especially the interests of consumers), he suggests a third alternative—"peaceful coexistence" made possible by "a sensible division of labor between the public and private sectors in achieving basic national objectives."

Regulation by Litigation

Decision to Prosecute: Organization and Public Policy in the Antitrust Division by Suzanne Weaver (Cambridge, Mass.: MIT Press, 1977), 196 pp.

The form of economic regulation practiced by the Antitrust Division of the Justice Department is an instructive alternative to regulation by commission, according to political scientist Suzanne Weaver of Yale. *Decision to Prosecute* examines the structure, personnel, and policies of this division during the years 1971–74 in order to learn about the "consequences of this court-oriented form of policy making."

Since the beginning of the twentieth century the Antitrust Division has been chiefly responsible for prosecuting violators of the Sherman and Clayton antitrust acts. The Sherman act (1890) prohibits attempting, conspiring, or

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combining to monopolize any line of commerce or to restrain trade in any line of commerce. The Clayton act (1914) prohibits specific monopolistic practices and acquisitions that have the effect of lessening competition measurably or creating a monopoly in any line of commerce.

Professor Weaver finds that the very organization of the division reflects the much-criticized ambiguity of American antitrust policy, an ambiguity that is related to the original legislation. For example, the Sherman act fails to define "unlawful restraint of trade"; and Senator Sherman's own speeches stress the political and social, as well as a modern economist's view of the consequences of monopolies and monopolistic behavior. Further, the Antitrust Division is shaped by the "imperatives of prosecution" and by the desire to bring and win as many cases as possible. The decision whether to prosecute is based largely on the likelihood of success, rather than on a theory of antitrust policy. But there are some situations in which most staff lawyers are reluctant "to bring a case they think they can win," for example, where prosecuting would have an anti-competitive result, where harm would be done to a small businessman, or where prosecution would "prevent or slow" the distribution of an "important commodity."

Staff lawyers in the division possess, and jealously guard, their considerable independence. This is so much the case that "where executives have actually tried to exercise authority in behalf of goals different from those of the staff, they have found that staff resistance and the outside opinion that supports it can make the exercise futile in the long run." But this same professional outlook serves as the major protection against improper influence by businessmen or politicians. That is, the concept of legal craftsmanship (which is the admired hallmark of the Antitrust Division) and the intimate relationship between the division and the private antitrust bar are, in the author's opinion, fundamental to the division's reputation of incorruptibility.

Various assistant attorneys general (AAG) who have headed the division have attempted organizational or public policy initiatives, but with mixed success. In general, straightforward reorganizations, such as AAG Lee Loevinger's move in 1961 to place all of the division's transportation-industry work in one section, are successful. On the other hand, policy innovations, like AAG Donald Turner's attempt to improve the economic quality of the division's work, encounter resistance and resentment. In the case of Turner's initiative, the "criteria of review" were changed by adding standards that were "alien" to the lawyers and "repugnant to their notions of good prosecution." Also Turner drew up guidelines for mergers that heavily emphasized economic-structural data and that tried to make the work of the division in this area, for the first time, predictable. Opposition from the staff to whatever restricts its short-run prosecutorial "reach" (in spite of possible long-range benefits) ended many of the Turner innovations as soon as he left the post.

Professor Weaver points out that some of the organizational arrangements now being proposed to reform regulatory commissions—such as "enabling courts to intervene more energetically"—already can be found in the Justice Department's methods of enforcing antitrust policy. She concludes that the division appears to be able to maintain a "faithfulness to legislative intentions" and that it has "escaped massive corruption by other interested parties." At the same time, however, the path of regulation by prosecution resists antitrust policy-making. One consequence in the division has been a strong preference for one version of competition with little recognition of possible complexities in the idea or of competing economic and social goals.

Perspectives on the 4-R Act

Railroad Revitalization and Regulatory Reform, edited by Paul W. MacAvoy and John W. Snow, Ford Administration Papers on Regulatory Reform (Washington, D.C.: American Enterprise Institute, 1977), 246 pp.

This collection of analyses and other documents was assembled by two economists, Paul MacAvoy of Yale and John Snow of the Chessie System (who is also a lawyer), as background for the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act). One important question addressed, according to MacAvoy, is, can a regulatory agency "effectively implement

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a basic reduction of its own powers?"

The volume begins with a 1973 report in which the Task Force on Railroad Productivity reviews what went wrong in the rail industry, emphasizing property taxation, passenger deficits, rail technology, regulation, the "fractured" corporate structures and labor-management problems. Then a 1973 paper by the U.S. Department of Transportation outlines the northeast rail problem and recommends that these railroads be restructured rather than nationalized, that the existence of a crisis as well as substantial northeast rail freight traffic must be recognized, that the system be streamlined (which would reduce jobs and service), and that regulation be reformed.

The United States Railway Association, in a 1975 paper making up the third chapter, discusses intermodal and intramodal competition and suggests that the former (competition between different modes of transportation) "may not be capable of producing some of the benefits associated with rail-rail competition" but that these benefits may be provided by "indirect rail-rail competition."

In Chapter 4, which is a 1975 memorandum from then Secretary of Transportation William Coleman, the railroads' problems are defined as redundant facilities and excess competition, outmoded regulation, archaic work rules, lack of capital, and preferential treatment of other modes of transportation. Secretary Coleman proposed two pieces of legislation, one of which, the Railroad Revitalization Act of 1975, became the basis of the 4-R Act. This is followed by John Snow's summary of the main elements of the Ford administration's proposal for rail regulatory reform—improvements in ratemaking, restriction of anticompetitive practices by rate bureaus, loan guarantees, and system restructuring. Mr. Snow's summary leads to a Department of Transportation staff paper in which the rail industry's benefits from regulatory reform are estimated at $985 million to $2 billion.

In Chapter 7, economic consultants Stephen Sobotka and Thomas Domencich suggest that the cost standards for rail pricing should be the standards of variable cost pricing until rail property wears out. Since "it has not been demonstrated" that there is any greater social value to railroads than to other kinds of economic activity, the authors are not convinced that society should subsidize railroads.

In Chapters 8 and 9, first an economist and then a lawyer address the question of rail-barge competition and predatory pricing. David Qualls of the University of Maryland concludes that the proposed water-carriers' amendments to the 1974 Transportation Improvement Act would not be in the public interest, because they might prevent technological innovation and lead to higher rates and prices. Law Professor Glen Weston of George Washington University opposes the water carrier amendments as unnecessary.

In Chapter 10, the U.S. Department of Transportation examines the question of rail abandonments outside the northeastern region, noting that there might be substantial impact on agriculture, milling, mining, and logging if they should occur.

In Chapter 11, John Snow (at that time deputy undersecretary of transportation) and Mark Aron of the Department of Transportation assess the regulatory reform provisions of the 4-R Act, noting that the results "are significant but not as extensive as those recommended by the administration." Chapter 12 is made up of ICC and Department of Transportation reports on the implementation of the 4-R Act.

In Chapter 13, economic consultant Norman H. Jones, Jr., discusses the concept of market dominance as it affects the pricing flexibility (especially upward flexibility) intended by the 4-R Act. He concludes that "intermodal competition pervades the transportation markets in which railroads participate" and that "rail market dominance can be considered the exception rather than the rule in virtually every market." On the other hand, as the Department of Justice brief that concludes the book argues, the ICC has defined market dominance in such a way as to avoid this conclusion. This brief criticizes the ICC for refusing to consider evidence of geographic and product competition even in rebuttal, for using an unreliable accounting system to compute costs, and for assuming market dominance based on a standard of investment that "is so vague as to be irrational." The effect of all this has been to contradict the intent of Congress that "railroads be free to adjust their rates without extensive litigation where effective competition exists."

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(Continued from page 4)

TO THE EDITOR:

This comment on Jeane Kirkpatrick's recent essay in *Regulation* is partly a fan letter because for the past several years I have admired her clear, cogent, and stylish writing, in both articles and reviews. By now my response to seeing her name on a magazine is to turn first to the page where her work begins. . . . But, in the case of this essay, for the first time in my experience with her writing, I have an impression that a central point is either incompletely made or even flawed enough to devalue the main theme.

I refer to Professor Kirkpatrick's characterization of contemporary welfare state liberalism as *incorporating* "the classical liberal's emphasis on individual liberty and individual rights." She moves toward this with the very sound observation that classical liberalism (which is where, generally, I would locate my own position) weights too lightly, or even ignores, the fact that other than government forces can impose serious constraints on freedom. It does not follow, however, that a reaction to this fact and an emphasis on "freedom from certain types of economic hardships" mean that welfare state liberalism "augments the commitment to individual liberty." It seems to me very possible—indeed an accurate description of the present situation—that most of welfare state liberalism can come to be simply a power-balancing act attempting to appease prominent blocs and lacking even the inclination to think about the ultimate consequences for a free society.

My uneasiness with Professor Kirkpatrick's treatment of a welfare state mode is reinforced by a very interesting piece by Stephen Haseler in the December *Commentary*. Haseler stresses the ominous theme that the welfare state mode in Europe is collapsing into socialism in a discouraging variety of instances. Certainly this runs counter to an unhedged contention that "the tensions between liberty and equality prove salutary in practice."

Admittedly, Professor Kirkpatrick distinguishes between the welfare state and what she calls *progressiste* liberalism, a "very different ideology whose principal goal is the destruction of the capitalist system in favor of a state-owned and controlled economy." But if Haseler is correct in his assessment, we have to face the probability that the distinction she makes is more form than substance. In his analyses, whatever distinction there was between social democracy (welfare state) and socialism (*progressiste* liberalism) became so bady eroded that "it was becoming difficult to point to the exact differences between social democrats and socialists." He says further that "this melding of social democracy and socialism is by now apparent all over Europe. The two terms are used interchangeably; and no great doctrinal . . . differences separate the social-democratic and socialist faction in any of the Left-of-Center parties."

I think that the central theme of Jeane Kirkpatrick's essay should be preserved to emphasize the links between liberty and a reasonable measure of equality, reasonably pursued. These can be complementary and mutually supportive. But not necessarily so, and not without a firm sense that the prime reason for valuing equality is its enhancement of liberty. The pernicious flaw in the now dominant welfare state attitude is that it includes no such orientation. . . .

Bert Elwert,
University of Illinois
at Chicago Circle

TO THE EDITOR:

Jeane Kirkpatrick's essay doesn't suffer for want of either scholarship or analytical imagination. And I am satisfied that I could live unafraid for my basic liberties in any political community where her personal judgment on the concrete issues of regulation, equality, and liberty was sovereign.

But, alas, I live, not in a true political community, but in a mammoth nation that has reached the point where Congress, the judiciary, and the executive annually penetrate ever more deeply into the remaining recesses of privacy and liberty. . . . What dominates the minds of most of our congressmen, a very large part of the federal judiciary, and just about every President is not liberty, but *equality*—the kind of equality that comes only from federal regulation of one kind or other. As our record of governmental action in matters of health, safety, desegregation, alleged discrimination in a whole plethora of areas, affirmative action, environmental protection, and, most recently and appallingly, in the revision of social security taxes demonstrates, we are scarcely deluged these days by governmental anxieties about our personal and family liberties.

There was a time, a long time indeed, when the author's reassurances about the "existential relations" that have always existed, and must exist, between liberty and equality would have comforted me. What she calls the "tensions" between the two values and within each of the values tended to resolve themselves, though admittedly never perfectly, within the then vast private sector. So tiny indeed was the public sector that it would never have occurred to anyone even half a century ago to refer to a private sector. There was simply American society, surmounted by an extremely limited and small federal government. Bureaucracy at any level was minuscule, and the idea of huge regulatory agencies empowered to order the details of human life was simply unknown; that is, until the present century.

I don't for a moment question Jeane Kirkpatrick's own dedication to—and, I vow, preference for—liberty, as compared with equality. And I reaffirm the second sentence of this letter. But the upshot of her article is nevertheless one more blow in behalf of an egalitarianism that is already threatening to suffocate individual liberties and to weaken the social order. To imply that there is no need to become concerned about the possible impact of equality upon liberty because there have always been tensions between the two values, and because each can be seen as reinforcing to the other, is Olympian, to say the least. I dare say there have been ages in which such extreme individual liberty existed as to give luster to the ideals of regulation and equality. But our age certainly isn't one of them. . . .

And a strange thing has happened. Measures like the progressive income tax, unemployment insurance, direct aid to the impoverished, infirm and elderly, social security, and other analogous acts of government—which, when they were enacted, were justified in the name of compassion or social justice—are now called "redistributionist" or "egalitarian." The inference to be drawn is obvious. Let us, then, simply "continue" the work of redistribution. . . .

Professor Kirkpatrick seems to me to assign equal weight to *liberty* and *equality*—that is, when neither is pushed to an irrational extreme—and this, I believe, is a great mistake. It is not necessary to invoke, as she does, "the *progressiste liberal*" to illustrate the mentality that, in our age, carries the

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value of equality to lengths destructive of the system of free private enterprise and economic freedom. The ordinary liberalism and the welfare state liberalism which she seems to accept, if not actually laud, are making enough headway, thank you, in the cause of egalitarianism. She speaks of "the democratic welfare state's continued emphasis on the liberty of the individual." I wish I saw some of that emphasis but, in fact, I see none—only occasional eruptions from political conservatives, which thus far have had some restraining effect upon the egalitarianism that liberalism of any kind has so largely accepted. . . .

There is only one kind of equality that reinforces liberty and that, of course, is citizens' equal access to the law and its courts. But who now cares about *that* relic of the seventeenth century? Today every significant use of the word *equality* culminates in what that great liberal Lyndon Johnson called equality of social condition or result.

Which, in our heavily regulated epoch, suggests another point. Whereas Professor Kirkpatrick sees a mutually reinforcing relation between equality and liberty, I see the same relation between equality and *power*. Power, when it becomes as centralized as it is in our government, invariably levels, destroys, or reduces the natural hierarchy of any social order or economy. Conversely, all efforts to bring about—to mandate—an equality of social and economic condition must end up with the bureaucrat, the police officer, even the soldier. The trouble with equality as a value is that although it aims at being a relation between individual and individual, it actually winds up as a new relation between individual and state.

Just one more observation. *Equality* in even the best of lights strikes me as an intrinsically mean word, lacking the nobility of such words as *liberty, freedom, justice,* and *rights*. . . . Mr. Justice Holmes wrote once that he hated equality because it inspired envy. So, I fear, it does. . . .

Robert Nisbet,
Columbia University

TO THE EDITOR:

Jeane Kirkpatrick quotes a verse which tugged at my heartstrings when I was young:

> The golf course is so near the mill
> That almost every day
> Little children at their work
> Can watch the men at play.

This no longer tugs at my heartstrings because I now know what the policy consequences of such sentimentality are. The Congress passes legislation requiring the mill to give each employee a membership in the golf club, a bag of clubs, and ten free lessons. This so raises the cost of production that the mill goes out of business and the children are thrown out on the street to engage in some unregulated or, possibly, illegal enterprise.

My point is not to deny the value of Kirkpatrick's insistence that curbing the liberty of one person may be the necessary price of expanding the liberty of someone else. My point is that this trade-off is not the issue in most questions of government regulation. Most regulations do not expand the liberty of the persons whose liberty is alleged to deserve expansion or they do so in an inefficient way.

(I use this circumlocution to conform to Kirkpatrick's vocabulary. She demonstrates the compatibility of liberty and equality, in part, by defining as liberty what I would call equality. Thus, she would describe a policy of income equalization as a policy of increasing the liberty of the poor at the expense of the liberty of the rich; I would call it a policy in pursuit of equality. In my terminology, much regulation is imposed in the name of equality, but this justification is rarely valid.)

We have a large family of regulations that restrict the liberty of some people and impair efficiency and at the same time restrict, rather than enlarge, the liberty of the people they are supposed to be liberating. A policy of restraining farm production to raise farm prices is the classic example. Such a policy has been defended as a way to increase the liberty (or income) of poor farmers. But in fact rich farmers and landlords are its main beneficiaries, poor farmers are not much affected, and poor consumers are injured. . . .

There is another category of regulations that may assist the poor—or whomever else they are intended to assist—but do so inefficiently in the sense that the same results could be obtained with less loss of total output and liberty. Minimum wage legislation may be an example.

Of course, government regulations usually benefit someone. So do snowstorms. And deregulation will usually hurt someone. But champions of regulatory reform have years of work ahead of them before they confront an inescapable conflict with interests that could be objectively described as deserving special consideration.

Although Kirkpatrick does not mention any economist more recent than J.S. Mill, she gives the impression that the classical or laissez faire tradition of economics is indifferent to concerns for equality. However, at least in this century this tradition has included strong support for the progressive income tax and, more recently, for the negative income tax, because these policies were thought to be ways to reduce inequality with minimum sacrifice of liberty and efficiency. Economists of this school have been worried about going too far with even such measures, not only because of a potential conflict with liberty but also because they believe that, beyond some point, the pursuit of equality would harm the poor by reducing efficiency and growth.

Kirkpatrick criticizes the classical liberals for failing to recognize that "government is not the only source of constraints on human freedoms." Without wanting to argue the relevance of other constraints, such as the law of gravity, I would point out that neither is government the only source of equalization. It seems to me obvious that the free market has been a powerful force for economic equality. . . .

Herbert Stein,
University of Virginia

TO THE EDITOR:

. . . In her article Dr. Kirkpatrick points out that the most common constraint on one's liberty to do what one wants is lack of money, and that giving full unregulated liberty to the unseen hand to do what it wants would leave millions of people with little money at all and, therefore, without much liberty. On target also are Dr. Kirkpatrick's observations that there are problems with the cumulative effects of individually inoffensive government regulations and with "the progressive transfer of power from the private to the public sector."

However, it would appear from her article that she views the cause of much of this transfer as being the well-meaning desires of do-gooders like me to have government regulate liberty so as to enhance equality. I see a much more practical (and perhaps therefore a more insidious) motive at work—simply the desire to get government funding. We are asking the government to pay for many things that were previously if inadequately funded privately: "private" charities turn

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out to work off government contracts, and "private" universities cannot subsist without government funds. Once the government funds a program, it must see that those funds are spent in accordance with its policies on discrimination, equality, and so on. Consequently, a myriad of new regulations appears, caused not by any original desire to regulate, but simply by the passing of many functions from private funding to state funding.

If the problem is that the nature of our present economy makes it unfeasible to finance many traditional functions without the taxing power of the state, then we must consider how to unlink the use of that taxing power from the government's responsibility to regulate. The answer may lie in allowing citizens to reduce their taxes by the amounts they give to designated organizations that were previously privately funded but which are no longer viable on that basis. As part of this change, we might need legislation making it clear that government would not be responsible for the social values embodied in the programs of these organizations.

In any event, Dr. Kirkpatrick's perceptive article should be read by every "radical" who calls for "egalitarian" dictatorships for the underdeveloped countries. . . .

Roy Godson,
Georgetown University

JEANE KIRKPATRICK responds:

In responding to my thoughtful critics, I should like to begin with some comments of a definitional sort. I agree with Warren Nutter that in the Anglo-Saxon political and philosophical traditions, freedom means something different from power. To say that a person is free to do x means not that he has the power to do x, but that the law (written or unwritten) of the society identifies x as an activity in which persons may engage without incurring severe sanctions.

With Nutter, I see freedom as meaning absence of coercion. And I wholeheartedly agree that absence of coercion should not be regarded as an instance of freedom from want. In fact, I believe the precise opposite: that freedom from want is one example of freedom from coercion. Of course it is possible to be a well-fed slave, and of course even fat slaves are not free. Where Nutter and I disagree is on the relation of freedom to government. Concerning that, I desire to make two points: first, that government is by no means the only source of coercion and, second, that preserving freedom sometimes requires using force against those who interfere with the freedom of others. Therefore, it does not "follow immediately" that any action of government designed to bring about greater equality "necessarily limits liberty properly defined."

In this country the blessings of order have been so long and so continuously enjoyed that we are always in danger of forgetting that order is a precondition to the enjoyment of *all* our rights and all our liberties. In addition to not being repressed by government, free speech also depends on *not* being driven from the soap box by neighborhood toughs, a free press also depends on the printers' *not* being able to smash the presses if they disagree with an editorial, and a free marketplace also depends on *not* having one's products destroyed or one's customers terrorized by the hired guns of a competitor.

The fact that rights do not exist simply as against government, that they are never absolute and that they are sometimes mutually incompatible remind us that questions about liberty, equality, and government turn on assumptions about how much force should be brought to bear to protect whose right to do what. I regret that the important questions in politics are almost always complex rather than simple, that they so often involve judgments among competing goods rather than between good and evil, and that they almost invariably require the exercise of prudential judgment rather than deductive reasoning.

Concerning Herbert Stein's comment about my defining as liberty what he would call equality, let me emphasize that, because poverty is *one* kind of constraint on liberty, increasing the incomes of the very poor increases *their* freedom. The problem here, I think, is that one cannot talk meaningfully about "liberty" in the abstract, but only about the freedom of particular persons in specific contexts.

I am truly baffled by Bob Nisbet's doubts about whether liberty can survive welfare state politics. The evidence (which Nisbet says he does not see) of the welfare state democrat's continuing concern for liberty is available in the practices of Western European and Anglo-Saxon welfare states. These are, in fact, the *only* nations in the world in which individuals enjoy basic political rights. We *know* that individual rights—to speak, publish, assemble, oppose, and enjoy due process—*can* exist in societies where the government plays a large role in the economy, because in fact they *do*. Certainly I did not desire to strike one more blow "on behalf of an egalitarianism that is already threatening to suffocate individual liberties and to weaken the social order." I do not think that our liberties are so threatened today from within. My impression is that never in history have Americans been more free—to write, speak, publish, assemble, move about, or otherwise to do as they please.

What the experience of Britain teaches, I think, is not that burgeoning bureaucracy under conditions of freedom destroys democratic liberties but that it may destroy economic efficiency, productivity, capacity for growth, and adversely affect the capacity to maintain the population's standards of living.

There is a fundamental question which, though addressed most directly by Elwert, is relevant to the other letters: that is, how much government control over an economy is compatible with the preservation of basic civil and political liberties. In fact we do not know. We know that in those societies in which government owns and controls all or most of the economy individuals lack basic civil and political rights (China, the U.S.S.R., Cuba, Yugoslavia are examples). We also know that none of these regimes came into being through erosion of liberty by a welfare state, but were born out of violence. We know too that civil and political liberties exist in societies in which government owns and manages a substantial "public sector" and regulates the "private sector" (Britain, France, Germany, Scandinavia are examples). We cannot be certain whether the progressive extension of the public sector in these countries would result in the loss of political freedom. Certainly it would if the progressive nationalization were undertaken by political leaders or parties that had no commitment to democratic liberties. This, I think, is the principal danger confronting France and Italy today. Both are threatened with the ascension to power of Communist parties who have, at best, a dubious commitment to freedom.

I may be less worried than either Elwert or Haseler (whose *Commentary* article I also found interesting) about the ambiguous relation between social democracy and socialism. It seems to me these relations have always been ambiguous. The

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French and German democratic socialists or social democratic parties, for example, have at various times embraced "socialism" as a goal, only to later change their minds. So has the British Labour party. None of these parties proposes to abolish the private sector. All are committed to the preservation of democratic processes and liberties. Social democratic or democratic socialist parties have always had different goals and methods from Communist parties. The efforts of Communist parties to blur these differences do not make the social democratic parties more "like" the Eastern European "socialists."

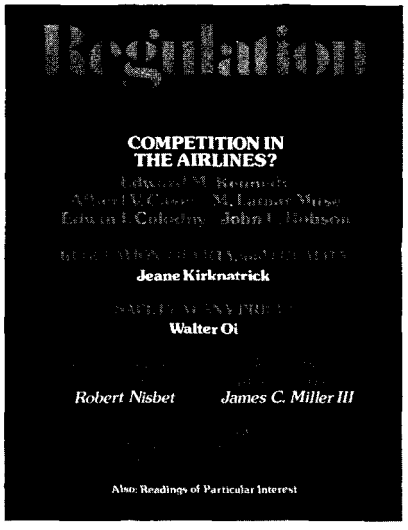
The preservation of democratic societies and organizations has always required vigilance against anti-democratic political groups. And the major problem today seems to be a flagging passion for freedom rather than an expanding public sector.

I favor all efforts to curb administrative and judicial rulemaking. I believe that Congress should be required to stop delegating so much power and should start taking more responsibility for the policies that circumscribe our lives. I agree entirely with Herbert Stein and Roy Godson that much government regulation has little or nothing to do with equality and everything to do with bureaucrats' use of power in behalf of their own goals. Massive busing, for example, is much less relevant to achieving equality of education than to realizing a vision of the racially integrated society. Edicts requiring that girls be permitted to compete in all athletic activities have less to do with equality than with the pursuit of a vision of a sex-blind society. The drive of government officials to expand their power over the lives of the governed is an enduring aspect of human behavior under virtually all known forms of government. Vigilance is also the price of freedom from unnecessary, undesirable, unauthorized, obnoxious regulators.

Like Bob Nisbet, I worry a good deal about efforts to replace custom with government regulation. However, the preservation of customary relations is not my most cherished value, and when custom denies citizens basic freedoms (as southern customs used to deny fundamental rights to blacks and wife-beaters deny the rights of their wives), I think custom must give way to laws designed to restore freedom.

To Herbert Stein I should like to add, first, that my references to classical liberals were limited to eighteenth and nineteenth century figures (this usage is standard among political scientists). Second, I doubt that the children in the Victorian jingle have, on being freed by government from the sweat shops, taken to illegal activities to earn an honest quid. I suspect, rather, that they all stay home watching television, where, thanks to the restrictions of the BBC, their fare will be a bit less harmful than that of our own less regulated airwaves.

Finally, it will be clear why I especially enjoyed Roy Godson's letter.



The Price of Safety

TO THE EDITOR:

Professor Oi's excellent article, "Safety at Any Price?" (November/December issue), covers the main issues in the rationale of safety regulation and sets the right tone for orderly discussion of wise policy in this area. However, I felt uncomfortable about his paragraph on "communal risks," in which he neglected to point out the harm that can come from being stampeded by publicity into accepting wasteful priorities.

He said: "Acceptable risk levels in situations involving 'communal risks' tend to be far lower than for individual risks. . . . Zeckhauser has argued that society will pay more for safety in a situation where there is one chance in 10,000 that ten lives will be lost than in a situation where there is one chance in 1,000 of losing one life. . . . When the lives of 200 passengers are at stake, the aggregate sum that these passengers are prepared to pay to reduce their risk is large—indeed, it may be over 200 times larger than the sum the lone executive will pay." This statement correctly indicates that airline passengers will pay more per vehicle trip to reduce the risk per vehicle trip than a single car driver would pay for the same risk reduction per automobile trip —exactly 200 times as much, I would say, if there are 200 executives in the airplane and one executive, without passengers, in the car. I cannot see why an executive, or I, should pay more for a given reduction in my risk of dying in an airline crash than for the same reduction in my risk of dying in an automobile crash. Therefore, I do not understand why Oi says "it may be *over* 200 times," or why he appears to approve of Zeckhauser's argument.

Zeckhauser is right that society pays more for safety in connection with rare but big fatal events than it pays in connection with common small events. An airline disaster provokes news coverage for several days, letters and articles on the Op Ed page of the *New York Times*, and so on. The loss of about 200 lives every day on the highways in the United States gets nothing like the same prominent coverage. If an FAA official is found at fault in connection with an airline accident—say, because he disapproved a budget expenditure for safety equipment —his career may be ruined. If a highway official disapproves a much smaller budget expenditure on highway safety features that would save hundreds of lives, no one hears of it, and there is no scandal. As a result, the government spends too much of its funds on airline safety and too little on highway safety. As a further result, each of us faces a needlessly high risk of accidental death. Better priorities would transfer funds from one to the other, reducing our risk on the highways by substantially more than the slightly increased risk in air travel.

Although the use of wasteful priorities is commonplace in our political system, saying that we have such priorities does not make it right. Informed discussion, such as we have in Oi's article and in other articles in *Regulation*, can reduce the role of passion and increase the role of reason in setting these priorities.

Martin J. Bailey,
University of Maryland

TO THE EDITOR:

As long as analyses like that offered by Professor Oi continue to obscure important differences between con-

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sumer product safety and worker safety, we shall not proceed very far along the way to achieving "acceptable risk." Whether social or private investment in safety is "reasonable" depends not only on a comparison of costs and benefits at the margin, but also on whether we as a society believe that the resulting allocations are fair.

Professor Oi observes that "the individuals who take the riskiest jobs are likely to be the ones who attach the lowest values to life and who incur the lowest accident costs [by definition] if injured." It is also often the case that persons who sell their safety for wages in hazardous occupations come to the marketplace with the smallest bundle of goods (wealth), for example, unorganized textile workers and day laborers. Naturally, these workers do not attach high monetary values to their lives and are willing to *sell* their safety at a lower price than most workers would. In contrast, it can be argued that consumers of automobiles or electric hair dryers represent a mix of the members of society as purchasers and, if a risk premium could be determined by an efficient market, that premium attached to products would bring a higher price for the same risk. The truth of the matter is that wealthy parents might buy their graduating child a sports car, but not allow him/her to hold a summer job in a foundry.

Now one may argue that imposing a higher degree of safety on workers than they themselves would choose is not a very good way to transfer wealth (income). Some may suggest that, instead, we give an amount of money to the worker which represents the difference between society's concept of a fair risk premium and the worker's current risk premium. This would allow the worker to put the added income to its most valued use. Aside from the fact that this transfer payment (like most others suggested to make us feel more comfortable and just) will not occur, it seems clear that few workers would switch to safer but lower-paying jobs. Adding the transfer payment would not equate the wealth of workers in hazardous jobs with that of the average citizen, and the lower risk premiums demanded by the worker would remain essentially unchanged. Whether we care or not depends on our sense of equity. Paying the difference between risk premiums might ease our conscience, but it would not reduce injuries.

Alternatively, we as a society may impose standards to prevent an injury frequency rate above a predetermined level. If this level is higher than the workers themselves would choose, the costs would be borne *partially* by workers, but also by producers and consumers too! If workers are presently equating the costs of industrial injury with monetary benefits at the margin, they would certainly be willing to reduce the costs (injuries) if only a fraction of their benefits (wages) were also reduced. It would be a mistake of analysis to equate workers with consumers (as Robert Smith has done elsewhere). Yes, some jobs *might* be lost or wages slightly reduced if more safety were imposed on the producer, but the costs would be shared by both the consumer and producer of that dangerously manufactured product whose price might go up. Unless products bear the full costs of production in a fair way—which, I submit, means that the magnitude of the risk premium cannot be set by the worker—consumers (and producers) will benefit from the fact that workers in risky occupations value their lives less than do consumers. In addition, the research of Thaler and Rosen regarding wage differentials has not been demonstrated to be generally valid in most hazardous industries, especially where workers are uninformed about hazards and are unorganized.

Whether mandated standards are in the "public interest" depends on how one views the public interest. To be just or fair may be argued to be as much in the public interest as to "minimize the sum of expected accident costs and accident prevention costs." If Professor Oi wants to define the public interest in a narrow or traditional economic way, he should at least be explicit about the fact that he assumes that either justice is served *only* if economic efficiency is achieved or that the public interest has nothing to do with justice.

Nicholas A. Ashford,
Massachusetts Institute of Technology

WALTER OI responds:

Mr. Ashford has written a remarkably empty letter. It conveys his displeasure with my essay but contains no substantive criticisms. Further, it reveals a very impressive ignorance about basic economic principles.

He objects, for example, to my emphasis on the criterion for evaluating "acceptable risk." This is evident in his concluding paragraph when he writes, "Whether mandated standards are in the 'public interest' depends on how one views the *public interest*. To be *just or fair* may be argued to be as much in the public interest as to 'minimize the sum of expected accident costs and accident prevention costs' [emphasis added]." How does Mr. Ashford define the *public interest* so that this public interest is served by the kinds of standards and inept enforcement activities which OSHA exercised during its first five years of existence.

There may indeed be instances in which government intervention can result in a lower sum of expected accident costs and accident prevention costs. In order to find cases in which such intervention is warranted, we need reliable studies and estimates of accident costs and prevention costs. Little is to be gained from simply asserting that public policy has got to recognize benefits of justice and fairness.

Ashford rhetorically writes, "Some may suggest that, instead, we give an amount of money to the worker which represents the difference between society's concept of a fair risk premium and the worker's current risk premium." Look at the reasoning following this sentence. It is filled with errors of logic and wrong economics. Workers do respond to pay differentials, and offering such a societal conscience differential will attract workers to hazardous jobs and *raise* the number of occupational injuries and fatalities. Finally, Ashford makes unfounded assertions about the studies by R.S. Smith and by R. Thaler and S. Rosen. The individuals in Thaler's and Rosen's sample data were, for the most part, low-paid and only partly organized workers who were allegedly uninformed about the occupational hazards. Mr. Ashford does not explain why these workers in hazardous occupations were paid risk premiums of the magnitudes found by Thaler and Rosen. Equilibrium risk premiums are *not* set by workers but are determined by the interaction of demand and supply forces.

Health and safety are now and always have been emotional policy issues. I had hoped that my essay would prompt readers to look at these issues in terms of the tradeoffs that consumers, workers, and employers make in deciding to accept varying risk levels. There is such a thing as "too much" safety just as there may be such a thing as "too little." ■

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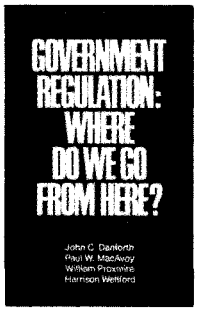

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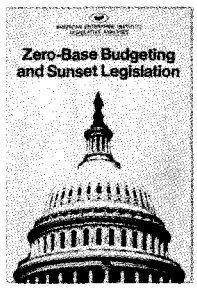

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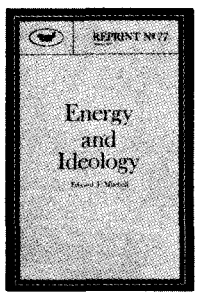

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